JOINT VENTURE AND PRODUCTION SHARING CONTRACTS IN LESS DEVELOPED COUNTRIES – A CRITICAL LEGAL ANALYSIS

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This work or any part thereof has not previously been presented in any form to the University or to any other body whether for the purposes of assessment, publication or for any other purpose (unless otherwise indicated). Save for any express acknowledgments, references and/or bibliographies cited in the work, I confirm that the intellectual content of the work is the result of my own efforts and of no other person.

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ABSTRACT:

The thesis principally examines the three categories of petroleum arrangements in Nigeria and gives examples of other developing countries. This study presents a systematic and in-depth analysis of both the structure and substance of some modern petroleum arrangements that have emerged in recent years and examines, the financial benefits of such associations.

The thesis is divided into two parts. Part 1 deals with participation agreements, joint venture and production sharing contracts, whilst Part 2 examines mutual benefit and marginalisation of the host communities. These agreements are usually long-term, without any mechanism for renegotiations and are shrouded in secrecy and confidential clauses. A good example is the NNPC and Ashland oil contract. Due to this lacuna, it is usually the practice for renegotiation to be done through the passing of a legal notice or new law, resulting in the presence of quite a few laws in the petroleum industry and the attendant mystification. This practice would have been simple if renegotiation clauses were enshrined in the agreement, enabling changing circumstances; and confidential clauses removed, aiding transparency in the transaction.

The study finds that some of the laws and the regulations are very old and clearly out of style with the times, not to mention in an industry that is forever changing and dynamic and further affected and determined by international factors. Further, the study also found that the activities of the oil and gas companies, to a great extent have not employed international best practices or remained compliant with the existing laws of the nation; resulting in oil spillages, various forms of pollution, serious health hazards, gross environmental degradations, rural agricultural destruction, distortion of social harmony and peace that exist in, and between host communities and have fuelled underdevelopment in these communities. As long as these social inequalities and injustice continue, human rights violations, gross mismanagement of natural resources, corruption in all forms and sizes exist and the activities of the participants in that sector are not addressed satisfactorily, so shall poverty, insecurity and serious threat to national existence and survival continue.

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CHAPTER 1

1. INTRODUCTION

On discovering crude oil many less-developed countries instantly think of it in terms of the revenue to be made from its extraction, production and distribution. However, to achieve this, they require the services of multi-national corporations who largely possess the technical expertise, capacity to absorb risk and the capital to carry out oil-exploration activities. The oil-rich, less developed countries are therefore compelled to rely on these multi-national oil companies to produce the oil and share the profits with them[1]. This is done by entering into a form of contractual agreement to share the oil produced with the multi-national oil companies in the form of oil taxes or oil profits. These forms of operational oil-production sharing agreements are what is called joint venture agreements or production sharing contracts that this study seeks to examine. Joint venture and production sharing contracts therefore characteristically entail the legal agreement between the host countries and the multinational oil companies to extract oil at its expense and risk with a view to paying oil profit or other compensation at an agreed ratio under the terms of contract[2].

1.1 THE SUBJECT: BACKGROUND TO THE STUDY

This is a study of the legal aspects of the relationship between some of the less developed countries and the international oil companies, and the directions this relationship has assumed in recent years. Once freed from the manacles of colonialism, the newly independent states had anticipated not only the ending of the economic supremacy of the former imperial powers within their states, but also a world order which would allow them more resources for the ordering of their own economies and admittance to world markets.

After the first flush of exhilaration over political independence, developing countries were quick to grasp the sobering fact that sovereignty is not synonymous with economic self-sufficiency or development and that the rich industrialised nations still retained control of the distribution of the world's resources. The cold war between

[1] Bernard Taverne, *Production Sharing Agreements in Principle and Practice* (Sweet & Maxwell 1996).
[2] Bernard Taverne, *Petroleum, Industry and Governments: An Introduction to Petroleum Regulation, Economics and Government Policies* (Sweet & Maxwell 2000) 268.

the then superpowers made the law an arena for ideological conflicts.[3] The independent movement, which arose in response to this opposition, exerted pressure to ensure that each newly independent state had absolute control over its economy. One avenue for the application of such pressure by the independence movement was by formulating new doctrines, using the numerical strength of its members in the General Assembly of the United Nations. A number of resolutions were passed declaring the doctrine of permanent sovereignty over natural resources and calling for the establishment of a new international economic order. This consciousness was also translated into a determined and continued attack on the international economic order and supremacy of the developed nations.[4] The attempts by OPEC countries to turn round obsolete patterns in the production and distribution of petroleum products through collective action are well documented.

The aim of the less-developed countries was the establishment of a more equitable international economic order, and the effective control of their respective economic resources. Developing countries have thus invoked various general, philosophical, juristic and pragmatic rationales such as equality, human needs, historic entitlement, the rectification of past injustice and the need for self-reliance and economic development.[5]

In the past, the metropolitan oil companies and companies which operated in other natural resources sectors used concession agreements to tie up production in large areas of land for substantial periods of time.[6] This picture, which originated in the oil industry, was reproduced in other mineral industries. The virtually identical pattern being employed around the world was another characteristic of this process. To this day, international business transactions retain comparable features; these make possible the formulation of a presumably uniform law around the world.[7] The

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[3] Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (2nd edition, Cambridge University Press 2010) 1.
[4] Samuel B Asante, 'Restructuring Transnational Mineral Agreements' (1979) 73(3) American Journal of International Law 335-371.
[5] D N Smith and L T Wells, *Negotiating Third World Mineral Agreements* (Cambridge: Ballinger Publications 1975) 335-371.
[6] The evolution and politics of the oil industry are well described in Daniel Yergin, *The prize: The epic quest for oil, money and power* (New York: Simon & Schuster 1991).
[7] This observable fact becomes the background for the arguments relating to a *lex mercatoria*. The wide pervasiveness of the joint venture form in foreign investment is an example in modern times. See generally, Muthucumaraswamy Sornarajah, *Law of International Joint Ventures* (Longman 1992). The existence of a common form facilitates the claim for the existence of a universal valid international business law, again created through a wholly private process. Its bases are to be found

concession agreements often effected transfers of sovereign power over vast tracts of land to the foreign corporation for long periods of time, in exchange for the payment of royalties calculated on the quantity of oil produced at a fixed rate. The system was kept in place by a convoluted web of power exercised by the home state and a concerted supremacy exerted within the international system itself by the major powers.[8] Several of these concessions have been subjected to legal scrutiny as they are subjects of international arbitrations. For instance, in Aminoil v. Kuwait,[9] the concession agreement which was involved was initially concluded between the Sheikh of Kuwait, at a time when Kuwait was a protectorate of Britain, and a US oil company. The royalty which was to be paid was two shillings and six pence for every barrel of oil. The agreement was to last for a period of sixty years. The terms of the contract were not to be altered without the consent of both parties.

Concession agreements were not limited to the petroleum sectors but were utilised in other mineral resources sector as well. The Ashanti gold fields' concession, completed in Ghana, provides an instance of an agreement to prospect for gold that was to last for one hundred years from the date of the agreement. The ruby mines in Burma were subjected to similar concessions. Analogous agreements existed throughout the developing world. They were executed in the context of unequal bargaining power, the rulers of the states agreed either because they did not have the power to oppose the terms that were imposed on them or did not have the proficiency or desire to bargain for better terms owing to lack of technical expertise. This led to a regrettable situation whereby the people of the state rarely benefited from these transactions made because of the lopsided nature of the agreements.

From the standpoint of democratic notions of sovereignty these agreements were deeply unsatisfactory. Time and again, they were signed by rulers who did not

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in writings of scholars and in arbitral awards rather than in the normal sources of international law such as treaties harmonising the law. The *lex mercatoria* is, in the conception of some writers, the law that applies to foreign investment contracts.

[8] Thus, the Iranian revolution in 1952 which affected the oil interests of the major British and American companies was ended through the collective exercise of power by Britain and the United States. The rule of Mossadegh was ended and the rule of the monarchy was restored. In the context of what happened two decades later, when the Shah was overthrown and an Islamic form of government established, it is contestable whether such interventions accomplish a useful purpose. They merely fuel more extreme forms of nationalism. See Alan W Ford, *The Anglo Iranian Oil Dispute* (University of California Press 1954); Jerrold L Walden, 'International Petroleum Cartel-Private Power and the Public Interest' (1962) 64(11) Journal of Public Law.

[9] *Aminoil v Kuwait* (1982) 21 ILM 976. For a discussion of the dispute, see Alan Redfern, 'The Arbitration between the Government of Kuwait and Aminoil' (1984) 55 BYYIL 65.

understand the implications of the contracts they were concluding or who did not care because they, being absolute rulers, could use the royalties they received for their own benefit. In some cases, these agreements were sustained by the fact that transnational governments were in control of the states in which they were made. For example, in Namibia, the South African government, (during the period of the agreement that the concessions that were made), favoured the interests of their own multinational corporations. As a consequence in recent times, the validity of such contractual arrangements, made through coercion or with unrepresentative governments, are regarded cynically in modern international law.

The structure of the mineral industries had to undergo change with the independence of the states in which they were made. In the petroleum sector, and to a lesser extent, in the other mineral resources sectors, rapid changes were brought about by collective action initiated by cartels of producer countries. There were dramatic shifts, where state oil corporations were created and vested with ownership of the oil resources of the state. The outmoded, outdated oil concessions were annulled. Consequently, the concession agreement ceased to be the norm within the oil industry and was replaced by the joint venture and production sharing agreement, under which ownership of oil remained, throughout the period of exploitation, with the state oil corporation. In this new form of agreement, transnational corporations carry out a participatory role, with the state-owned corporation having dominant control of the operations. Such agreements reflect the shift in the power equations that have taken place within the oil industry. The shift was aided by the formulation of international law doctrines such as the doctrine on the permanent sovereignty over natural resources. There is a growing controversy amongst commentators as to the nature of such doctrines and their views may differ.[10] Some regard them as *jus cogens* principles and others as sheer *lex ferenda*. In many developing states, it is now a settled principle of law that such practices have been incorporated in constitutions and in foreign investment codes.[11]

As petroleum assumes increasing importance in the world economy, foreign oil companies are now left with no choice but to compromise many of the traditional

[10] For a survey of a different views of the doctrine, see generally Nico Schrijver, *Sovereignty over Natural Resources: Balancing Rights and Duties* (Cambridge University Press 1997); M S Rajan, *The Doctrine of Permanent Sovereignty over Natural Resources* (OJL 1982) 12.

[11] See for example, Article 12 of the Philippines Constitution and the Constitution of Papua New Guinea.

prerogatives which they have enjoyed in the undeveloped world. The Production Sharing Contract (PSC) stands out as an important effort to equalise the historic imbalance between the host country and the multinational corporations. Although, such contracts seem to exaggerate the actual shift in power between the parties, they provide an appearance of equality as well as a means for ultimately achieving such equality.

There is a growing recognition that the production sharing agreement in the oil industry provides the best example of contractual arrangement for the exploitation of petroleum. It is futile to argue that the doctrine has no legal substance and it is a mere expression of fanciful desirable norms when it has been acted upon time after time. In the mineral resources industry, which it was mostly designed to influence, the doctrine of permanent sovereignty over natural resources reflects a sea change that is now well established. In any event, it basically emphasises a truism in international law that the sovereignty of a state encompasses control over all persons, incidents and substances inside a state, save where such control has been removed by treaty.[12]

Even though the control of the natural resources sector by transnational corporations has been broken, the command of technology and capital that these corporations have, makes them key players in this sector. Nationalisation may have ended direct control. Without a doubt, modern legislation reserves the rights to the natural resources sectors to state corporations or, otherwise, to nationally controlled corporations. Hitherto, alliances with the foreign corporations have been essential to operating the sector, as these transnational corporations possess the technology and risk capital necessary for the exploration and exploitation of the resources. The interest that multinational corporations create to carry out activities in this area need protection and become a focus of the international law of foreign investment. Presently, there has been a perceptible sway towards the protection of the interests of transnational investors which is associated with the drift towards liberalisation.[13]

Over an extended period, the activities of the multinationals have come under increasing scrutiny and criticism. Some authors argue that an increasing integration and overlap in the activities and policies of multinationals encroach on an increasing

[12] Sornarajah (n 3) 43.
[13] *Ibid.*

number of economic issues within host states, particularly those of the developing countries.[14] Conversely, other writers have taken the extreme view that the transnational oil companies' policies are not justifiable and undermine the respective sovereignty of the host states.[15] The threat that multinational oil companies pose to sovereign states was a preoccupation when Multinational Corporations first started to invest abroad.[16] Backed by its own immense financial resources and power of its home state which stands behind it, the fear was that the multinational may influence the political course of the state in which it seeks to invest. It could scuttle the economies of weak states by simply relocating its operations elsewhere.

Similarly, some authors have acknowledged that multinational corporations, notwithstanding its enormous power both for good and for harm, has hardly been recognised as an entity capable of bearing rights and duties in positivist international law[17]. Apparently, this position must change, given the reality that it is as dominant an actor on the international economic vista as the state. There is no doubt that many multinational corporations command financial resources that are greater than many states can amass. Outsized hegemonic powers therefore act to advance the interests of multinational corporations.[18]

While it can be stated that in a joint venture, the motives of the multinational corporation and the state entity will often be in conflict, the multinational corporation is enthused by the need for immediate profit.[19] The host state, on the other hand, has or ought to have long term economic objectives of development and seek to pursue these through the joint venture with the multinational corporation. The synergy necessary for the success of the joint venture will be wanting in such an association and the potential for conflict is immense. There are, however, rules of international law which accord to host state entities a favoured status and make them immune, to a certain degree, from the processes of domestic courts. The entire

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[14] *Ibid;* Susan Strange, *The Retreat of the State: The Diffusion of Power in the World Economy* (Cambridge University Press 1996); and Claire Cutler, Virginia Haufler and Tony Porter (eds) *Private Authority and International Affairs* (Suny Press 1999).
[15] *Ibid.*
[16] *Ibid.*
[17] David Ijalaye, *Extension of Corporate Personality in International Law* (Dobbs Ferry: Oceana Publications, Leiden A W Sijthoff 1978) and Ignaz Seidi-Hohenveldrn, *The Corporation In and Under International Law* (Cambridge University Press 1987).
[18] The case of Iraq is probably a good example; the sensation by the media that the Iraq war was fought at the instance of the huge oil and construction companies, if not a fallacy supports this possibility.
[19] Ijalaye (n 17).

question of the applicability of sovereign immunity to host state entities has been difficult but this issue, however, is being resolved by the wide acceptance of the rule that such immunity cannot be claimed by a state entity which engages in commercial activities.

Also, in contrast to the criticisms of some authors and some non-intergovernmental organisations, this thesis is not a study of the political and social justifications for either the multi-national corporations' or the host states' policies on reaching joint venture agreements for either's objective. It is, rather, a legal inquiry into whether their relationships are mutually beneficial to each other, with a view to making far-reaching recommendations that preserve State's sovereignty over their natural resources and ensure the welfare of the citizens of less-developed countries from their exploited natural resources on one hand, whilst guaranteeing profits to the multi-national corporations for their risk and capital on the other hand.

It is a well acknowledged fact that flexibility and adaptability are to be considered necessary as stabilising influences in petroleum contracts, and some have called for the formulation of terms which are elastic enough to satisfy the concerned parties, principally with regards to the fiscal terms which certainly form the core of any contract. Omorogbe is of the view that these aspirations are better attainable by the design of a universal model contract which will be mutually beneficial and which could, by means of an adequate number of variable parameters, be made flexible enough to take into account, cavernous differences in the chances of finding petroleum or in the cost of operations.[20]

An interesting twist is the role of non-governmental organisations in fostering or weakening these agreements. Whilst one of the cardinal policies of a non-governmental organisation is their ability to mount an international campaign against the acceptance of the multilateral agreement on investment,[21] their mobilising wherewithal was publicised in protests against the WTO at Seattle and Cancun, consecutive World Bank meetings, and at whatever time the institutions viewed as

[20] See World Petroleum Arrangements (1989) in Yinka Omorogbe, 'The Legal Framework for the Production of Petroleum in Nigeria' (1987) 5 JERL 273-290.
[21] Robert O'Brien, *Contesting Global Governance: Multinational Economic Institutions and Global Governance* (3rd edition, Cambridge University Press 2000).

being associated with neo-liberal notions met in the western capitals.[22] Further, the foremost plank in their gripe against the making of the code is their highlighting on the protection of multinational corporations without at the same time taking into account the environmental degradation and the human rights abuses that they are capable of.

Views put forward by human rights groups assert that a multinational code on investment should be unbiased, bestowing protection on foreign investment but pointing out responsibility when there are violations of the associated environmental and human rights standards.[23] In addition, human rights groups have also helped to shift the law from the protection of multinational corporations' investments to a consideration of their responsibility for misconduct and breach of their contractual obligations to their host nations.

Even though in recent years, there has been some academic discussion of new forms of contracts utilised by developing countries, recent legal studies seem to suffer from a number of pervasive deficiencies.[24] Firstly, many of these studies and comments have, to a large extent, been expressive of difficulties and dissatisfactions but there has been no in-depth and systematic legal analysis of the contractual systems. Secondly, existing literature tends to approach the subject in a progressive manner. Little has been written in terms of a comprehensive and comparative study of these arrangements in developing countries, particularly Nigeria.

Furthermore, little legal ink seems to have flown towards critically addressing the question of the transnational oil companies' impact on the oil-producing areas with respect to the consequences of the activities that the kind of production sharing agreements entered into by them have on their less-developed host states. This is

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[22] This is important as the protests against neo-liberal capitalism did not take place in the developing states but in the capitals of the developed states. The popular view is that the cavernous gap between the rich and the poor had brought the third world into the developed states, in that the poor in the rich world were acting as surrogates for the poor in the developing states. Caroline Thomas, 'Developing Inequality: A Global Fault-Line' in Stephanie Lawson (ed), *The New Agenda in International Relationships* (Blackwell Publishers 2002).

[23] The responsibility of multinational corporations for environmental and human rights violations is dealt with in Chapter 7 of this study.

[24] For further commentaries, see Abdulaziz Al-Attar and Osamah Alomair, 'Evaluation of upstream petroleum agreements and exploration and production costs' (2005) 29(4) OPEC Review 243-266; M B Umar, 'Legal Issues in the Management of Nigeria's Production Sharing Contracts: A case study of the Nigerian National Petroleum Corporation (National Petroleum Investment Management Services) Perspective' (2005) 3(1) OGEL; Yinka Omorogbe, 'Contractual Forms in the Oil Industry: The Nigerian Experience with Production Sharing Contracts' (1986) 20(3) Journal of World Trade 342-349.

largely because it is not just for stakeholders to concern themselves exclusively with strategic economic interests without regard for the welfare of the dwellers of the local community and their well-being. Thus, another purpose of this study is to investigate the impact the oil-production agreements entered into by host states and the multi-national companies in the oil industry and their activities have on the native populations in oil-producing communities.

Various earlier studies on the Nigerian oil industry have been mainly concerned with trends in production, markets, revenue, environmental pollution and economic growth. These studies have no doubt proven helpful to the oil companies and the government, but inadequate attention has been given to determining the transnational and production sharing agreements' impact on the indigenous people. This study considers whether the creation of competing objectives of protecting human rights and the environment from the abuse of transnational corporations leads to the recognition of the regulatory right of the state to interfere in circumstances where the transnational corporate investor abuses human rights, such as labour rights, or causes environmental pollution. The study further considers whether the increasing recognition of such regulatory rights will undermine the aim of investment protection and require the recognition that a state has the right to intervene in an investment that poses a serious danger to the environment or involves an abuse of human rights.

1.2 OBJECTIVES OF STUDY

The aim of this research will be the critical analysis of the fundamentals of joint venture and production-sharing contracts with a view to proffering alternative and more practical solutions than such arrangements have been found to possess. In addition, this work is concerned with the elimination of possible areas of conflict that could arise within a long-term contractual relationship for the exploration and production of crude oil, primarily between a host country and an oil corporation. It further pertains to the design of an oil contract that satisfies the aims, objectives and aspirations of the parties and also remains mutually beneficial to the parties themselves in particular and their transaction environment in general. Other issues that will be raised in passing will be examples drawn from the impoverished, less-developed countries of the world that have, in one way or another, suffered greatly from the activities of the oil companies who have come to exploit their natural resources and unfortunately contributing to their resource curse. Examples will be drawn from such less developed countries as Nigeria, the point being that wider issues will need to be considered in future when drawing up international contracts.

1.2.1 Key issues to be addressed:

(1) What are the significant differences between concessions and contracts?

(2) What are production sharing contracts?

(3) How did they originate and what has been their subsequent development?

(4) How wide has the concept been extended geographically?

(5) What sort of variations exists in different countries that can be imbibed by oil-rich, less developed countries?

(6) What are the desirable improvements to these contracts and how can they be implemented in less developed countries?

(7) How can agreements be geared towards protecting the needs for sustainable development and protection of the environment?

(8) How has the petroleum production sharing agreements entered into by less developed countries adversely affected them especially the exercise of their sovereign rights over their natural resources and the returns to the people and how can this be addressed by the law?

The fundamental aspects of the petroleum arrangements will be covered in the literature review and conceptual framework. In the course of this research work, the following incidences of Petroleum sharing agreements would also be elucidated upon:

(a) Risk and financing;

(b) The issue of economic return; and

(c) Terms of management for the ongoing arrangement.

Normally, the international company is said to be the "operator" of the venture and is subject to "supervision" by the government inspectors, with government committee representatives that exercise *de facto* control over their activities. To what extent this is true on the ground, and how much control these government officials exercise in fact, will be an additional focus of the literature review; with a view to gaining a clear understanding of what has gone before, and how the principles of previous agreements have actually functioned, irrespective of how they have been perceived and formulated. Knowledge and technology transfer issues will be at the core of these considerations.

In addition, this research will highlight the main features of the various arrangements, their legal nature and will analyse these primarily from the host country's perspective.

1.2.2 This research will aim to clarify:

1. Conceptualisation of terms;
2. The inherent vicissitudes in the present arrangements;
3. Whether Joint Ventures and Production Sharing Contracts are mutually beneficial to the parties involved;
4. The effect of such agreements as they affect the inhabitants of the communities in the less-developed countries;
5. The infrastructure provided by these companies and the inadequacy of such amenities. Example will be drawn mainly from some developing countries.

Critically too, since the development of a country's natural resources seems to be the pivot around which poverty, indebtedness and corruption have become ensconced in most developing nations, this essential dilemma of the resource curse would be addressed.

1.3 STATEMENT OF THE PROBLEM

Ever since the emergence of the modern petroleum industry at the turn of the last century, petroleum exploration and exploitation in developing countries has been controlled by international oil companies, rather than the developing host countries themselves because the latter lacked the capital and expertise essential for the extraction of the resources. Notwithstanding the development of local capability and know-how since the last century, this state of affairs has not changed significantly. It is probable that this pattern will continue, because developing countries still require foreign risk capital and technology and transnational companies will still need the authorisation of host countries to carry out exploration and production operations.

As the industry has progressed and governments have become more acquainted with both the technology and the markets, the sophistication of the regulation of the industry has increased. This sets the stage for the contractual relationship between the two actors: the government as the 'landlord' and the company as the 'tenant'. To continually run this business relationship, a form of petroleum extraction and profit sharing agreement is reached and often allegedly skewed in favour of either party depending on certain circumstances like, the holder of the bargaining chip, legal expertise, the desperation of the host country to make huge profits, governmental corruption, tax regime, the licensing regime, the attachment of importance to State's sovereignty over their natural resources and whether the host state is a newly discovered seat bed of natural resources with neither experience nor knowledge.

Petroleum exploration and exploitation by foreign companies in developing countries is therefore an exclusive business in a complex industry. It links governments, owners of natural resources, and companies, investors of private capital, technology, and equipment obligatory for resource development, in a single sector where the stakes and risks, as well as the possible profit margins, can be very high. Consequently, the questions of how to provide for contributions to the partnership, the allocation of the petroleum profits and oil tax returns, breach of the contractual terms, propensity of a party to cheat the other, the interference of such foreign partnership with state's sovereignty rights over their natural resources, the effect of the oil exploration activities predicated on such concessional or contractual agreements and their socio-economic and environmental impact on the citizens of less-developed host states have always been lingering problems in the arrangement between the two contacting parties.

1.3.1 Fundamental conflict in objectives

In recent years, the developing countries have progressively become aware of the importance of the oil from which they can derive the financial resources required to undertake their economic and industrial development. The large sums deployed by the oil industry in other sectors and the high level of profits accruing to it have led these countries to seek, by appropriate fiscal measures and stringent economic policies, a growing share of the revenue derived from oil production. With time, increasing participation of host countries in most spheres of activity culminated in progressive increases in oil taxation and a substantial indigenous control of their exploited natural resources.

The main objective of the transnational oil company is to ensure a satisfactory and sufficient level of profitability for the operations they undertake at such huge risks and capital investment. This position is logical as they alone bear not only the burden of the obligatory investment but also the risk attendant upon it. They thus desire to maximise operational freedom and equity returns, minimise political risks imminent in the face of political instability, provide for stabilisation of their investment and minimise operational costs. This relationship is also intrinsically unstable due to a number of factors.

Firstly, the underlying objectives of the two parties are not only different but are also, often times, conflicting: Host countries are interested in making use of foreign investment to develop their resources for the benefit of national economic progress, while foreign companies are generally profit-motivated, gain-oriented and interested in minimising their investments at the least risk. There is also the need for the host states to balance its conflicting interest between economic objectives and environmental preservation through regulation.

Undoubtedly, then, the fundamental objective of oil and gas contracts should be to seek a balance of the interests, rights, obligations, and benefits, between the two parties, to produce greater mutuality of interests, commerciality, and stability. The concern is therefore whether this can be realised, facilitated or remedied through the contract itself, or whether the situation is intrinsically unfair and unstable due to the imbalance of powers between the contracting parties. Following the demise of the traditional concession, the battle for control over the oil between international companies and developing countries encompasses one of the impressive acts of the great drama of decolonisation and national independence in the post-World War period. In the past few decades, a number of modern contractual arrangements have developed in the petroleum sector which form an integral part of this research work to be analysed in subsequent chapters.

1.3.2 Stability

It is essential that, in seeking to attain the objectives of state, the host oil-producing country provides a stable, transparent and efficient legal system and administrative structure. Anything else would constitute a significant risk to the potential investor and deter investment and development. This is the stability question. Further, a proper and well-defined legal and administrative framework represents a strategy for development which employs mechanisms designed to achieve state objectives. More so, oil companies prefer to invest in those countries which have favourable geology and proven resources of oil and gas to reduce their chances of losing their capital to unprofitable investments.

Petroleum legislation is the basic instrument employed by governments to regulate the exploration and development of petroleum. These laws basically set forth the major principles and assign the petroleum to the standard authorised government agencies – often state petroleum companies – to negotiate petroleum development agreements. These agreements, and some subsidiary petroleum regulations, constitute the hard core of the legal regime applicable to petroleum activities.

The main purposes of a legislative framework are:

1.) To provide the basic context for and the rules governing petroleum operations in the host country;

2.) To regulate them as they are carried out by both domestic and international corporations and

3.) To define the principal administrative, economic and fiscal guidelines for investment activities in the oil sector.

In the petroleum industry, the vast amounts involved militate against allowing disputes to remain irreconcilable and therefore, the great majority of differences that arise under such arrangements are solved by negotiations between the parties, often without recourse to third parties. At times, however, the conflicts are more deeply rooted and cannot be easily negotiated away by the parties. They could sometimes deteriorate to an extent that a major dispute arises and one of the parties becomes so disenchanted as to be unwilling to continue the association. Most times such relationships have involved a sovereign state, usually from a developing country. Most of these developing countries have reacted to such occurrences by adopting drastic actions, such as nationalisation, indigenisation, expropriation, and renegotiation of such agreements, or taking such actions as termination of the contracts, whilst damning the consequences including trade sanctions and discouragement of foreign investments in their country. The investment relationship is destroyed and in such cases restitution *in integrum* is not a practical remedy.[25] Investments into the host country often suffer a severe setback because of reluctance by many investors to invest in an expropriation-prone country.

1.3.3 Fairness

The inappropriateness of the old regime that led to instability and contractual breach gave birth to such new forms of agreement as joint-ventures and production sharing contracts. The traditional concessions regime contained a number of terms and features which reflected the imbalance in the bargaining powers of the contracting parties. As a result, the regime was faced with growing criticism, focused mainly on the inconsistent provisions that were inherent in the traditional concessions and which were mainly in favour of the oil companies.

From the look of things, the new generation agreements have not generated a significant shift in the beneficial allocation of benefits, even though bargaining powers continue to shift in favour of the host country. The new generation agreements no doubt have provided ways of sharing symbolic power and economic benefits in ways different from the traditional concessions, but the fact remains that they have not eliminated the complex technical problems relating to the allocation of financial benefits and financial risks, technology transfer and the transfer of knowhow. Therefore, to date, serious technical issues have remained – no matter the structure of the agreement.

[25] Yinka Omorogbe, *The Oil and Gas Industry: Exploration and Production Contracts* (Lagos and Oxford: Malthouse Press Ltd 1997) 2.

The exact question raised here is how petroleum arrangements can be improved for the benefit of all parties, including the interests of the world community at large and those of future generations. One of the most significant developments in international petroleum law over the last few years, and perhaps in the last century, has been the rapid reform in the petroleum sector, stimulated by strong competitive forces following the collapse of oil prices in 1985 and the breakdown of state socialism. Economic cooperation between governments and companies and investment competition among producing countries may replace ideology and politics as the focus of conflict in the government-company relationship that has prevailed in the last decades. Throughout the oil and gas business, the emphasis has been on petroleum reform and rationalisation in the form of privatisation, deregulation, de-monopolisation, investment promotion, and so forth. An effort is thus made in this study to include these recent developments in negotiating international petroleum agreements.

In recent years, this situation has improved somewhat, but significant collections of petroleum contracts are generally not yet readily available. Nearly all parties to modern contracts be they governments or companies, still consider the documents to be private, and few contracts are available for publication or even limited dissemination. Consequently, there is, to date, no transparency in international petroleum contracts.

Under the general principles of law,[26] whether it be contract law, constitutional law, or even criminal law, the agreements, rights and obligations of corporate bodies and individuals are regulated by law, terms of contract, and the obedience to civil law. As parties are bound by their agreements, no party can be prosecuted on the grounds of immorality. Similarly, in international law, treaties, rights, and duties bind parties and obligations arising from such treaties have legal validity and create international legal obligations. Also, obligations arising from the creative ground-breaking policies of one of the parties, whether it be the state or non-state actor, affect the rights of the parties upon whom the obligation is imposed.

[26] Under Article 38(1) of the statute to the International Court of Justice, 'general principles of law' are unclear and controversial but may include such legal principles that are common to a large number of municipal law. Given the limits of treaties or customs as sources of international law, Article 38(1) may be looked upon as a directive to the courts to fill any gap in the law and prevent *non liquet* by reference to the general principles. See generally, M Cherif Bassiouni, 'A Functional Approach to "General Principles of International Law"' (1990) 11(3) Michigan Journal of International Law 768-818.

The correlation of various economic, political and historical issues shape and continue to shape the development of international law on transnational investment. If international law is created by the ultimate resolution of conflicting national, business and social interests, the international law on transnational investment provides a picture of these processes of incessant conflict and resolution at work. It is an area in which the interests of capital exporting countries have clashed with the interests of capital importing countries. The ensuing resolution of the conflicts, if only any resolution is unquestionably achieved, demonstrates how international law is made and how imprecise the formulations of its principles are in the face of deep conflicts of views as to the law between states. International Investment Arbitration as a branch of law addresses a part of this and these conflicts become underscored when other actors in the field split behind the states and embrace the contesting norms that each camp supports.

1.4 RESEARCH METHODOLOGY

1.4.1 Realist rather than Positivist or Natural Philosophy

The methodology is founded on the doctrinal literature survey and on a legal qualitative analysis based on the realist philosophical school of thought and legal jurisprudence that the policies and decisions of the host countries and the multinational oil companies must conform with the terms of the contract to promote the economic development and progress of such host countries under the checks and balances of international development law. This presupposes that international development law, conventions, rules, or the declaration of UN general assembly resolutions on permanent sovereignty over natural resources, including the general principles of law, are a unique socio-political phenomenon guiding the behaviour of host states and transnational companies in international relations – this would form a significant portion of reliance in this study.

The methodology does not underplay the positivist and natural philosophical approaches, but after evaluating the international law and before the universal acceptance of permanent sovereignty over natural resources as a legal norm and doctrine, the realist philosophical approach is adopted. Although most theories of international law are rooted in positivism and are aimed at explaining law as an existing, static phenomenon unaffected by political and other trends, such theories are inadequate when an attempt is made to apply them to a situation where the existing principles of law, formulated at a time when they were kept in place by hegemonic control and dominance, are under attack. Other theories are unsuitable, seeking to achieve objectives based on morality and conscience. These theories are also inadequate to explain a situation in which alternate value systems of rather equivalent moral validity are in conflict. Where existing rules supported by the established group of nations are challenged by somewhat new members of the international community,[27] they become feeble and, until they are replaced, a situation of bedlam or normlessness will exist. The task of decision-makers and scholars will be to examine the conflicts between the alternate sets of norms in these areas and ensure that adjustments are made to bring about some acceptable mutually agreed upon and universally acceptable norms so that the state of normlessness may be ended.

1.4.2 Research Methodology

This work addresses the subject matter by adopting a doctrinal approach. It will be presented in a descriptive, analytical and prescriptive manner.

Doctrinal Approach

The doctrinal or black letter law approach refers to 'a detailed and highly technical commentary upon, and systematic exposition of, the context of legal doctrine'.[28] This method is at the basis of conceptual analysis and it is a core research methodology for legal research. It provides a systematic relationship between rules, whilst explaining areas of difficulty and future development.

There are a number of criticisms levied on the doctrinal approach. Primarily, it is often thought that this approach was too subjective and lacked scientific corroboration. In response to this criticism, Langdell in his Preface to Contracts sought to promote legal doctrine as a science, in which he explains:

[27] The European origins of international law have been extensively commented upon. One view is that new nations are born into the world of existing law and are bound by it. See Daniel P O'Connell, 'Independent and State Succession' in William V O'Brien (ed), *New Nations in International Law and Diplomacy*, (London: Stevens & Sons for the Institute of World Polity 1965). The opposing view is that they may seek revision of existing rules of international law, as they are not bound by these rules.

[28] Michael Salter and Julie Mason, *Writing Law Dissertations: An Introduction and Guide to the Conduct of Legal Research* (Pearson 2007) 31.

Law, considered as a science, consists of certain principles or doctrines… Each of these doctrines has arrived at it present state by slow degrees; in other words, it is a growth, extending in many cases through centuries. This growth is to be traced in the main through a series of cases… Moreover, the number of fundamental legal doctrines is much less than is commonly supposed… If these doctrines could also be classified and arranged that each should be found in its proper place, and nowhere else, they would cease to be formidable from their number… It seemed to me, therefore, to be possible… to select, classify, and arrange all the cases which had contributed in any important degree to the growth development, or establishment of any of its essential doctrines.[29]

This view was further corroborated by Kimberly who argued that the law 'ought to be studied from its own concrete phenomena, from law cases, in the same way that the laws of the physical sciences are derived from physical phenomena and experiments'.[30]

In any case, with using the doctrinal approach, one needs to:

1. Organise and reorganised case laws into coherent elements, categorised and concepts.
2. Acknowledge the distinction between settled and emerging laws.
3. Identify differences between majority and preferred or better practice ideally with some of the explanation for the criteria to be used.

From the above, doctrinal work may be associated with three broad steps; namely reading and gathering facts, analysing legal issues found, and finally, synthesising all the issues to a conclusion.

[29] C C Langdell, 'A Selection of Cases on the Law of Contracts' (1871) quoted from B Kimball, *The Inception of Modern Professional Education: CC Langdell* (2009) 349.
[30] *Ibid* 351; J Redlich, *The Common Law and the Case Method in American University Law Schools* (1914) 15.

Descriptive analysis

Descriptive analysis refers exactly to what the name implies. It involves the ability to capture many vivid sensory details that appeal to a reader's sense including sight, hearing, touch, smell and taste where appropriate. In this work, descriptive analysis is adopted to summarise raw data to make it easily interpretable to the reader. Good descriptive analysis may involve the use of figurative language such as analogies, similes and metaphors to assist the reader capturing the message the writer is trying to convey. It may also involve describing the past and making reference to any point of time when an event has occurred, even if it is one minute ago or one year ago. In terms of its functionality, descriptive analysis allows us to learn from past behaviours and understanding how they might influence future outcomes. It also provides an overview of the plot by examining both the content and structure of the story. In terms of content, it draws special attention to characters and their relationship, describing settings and providing a general overview of leading events. It must be understood however that, its main obligation is not of theory development, even though through from the facts described, it can provide useful hints both for theory building and theory reference.[31]

Analytical analysis

This type of writing is used to break a problem down into the elements necessary to solve it. This is particularly important in this study for developing an insight and understanding on a particular subject matter, as well as for comparisons with numerical and experimental results.[32]

Prescriptive analysis

This involves the application and computational sciences. It involves options to take advantage of the results on descriptive and predictive analysis. Predictive analysis adopts a variety of statistical techniques, sometimes involving data mining and predicting modelling as well as analyse current and historical facts to make predictions about future or otherwise unknown events. Prescriptive analysis is an

[31] M K Malhotra and V Grover, 'An Assessment of survey research in POM; from constructs to theory' (1998) 16(17) Journal of Operations Management 407-425; and J G Wacker, 'A definition of theory: research guideline for different theory-building research methods in operations management' (1998) 16(4) Journal of Operations Management 139-152.

[32] *Ibid.*

analytic science that guides decision-making for businesses. It adds value by providing notable clarity to other types of analytical approaches.[33]

In this study, two further methods will be used. Firstly, library-based research will be carried out to review the literature of other authors, subsequently a socio-legal research methodology will be used to conduct the survey, in which practitioners in the petroleum field will be interviewed. The design of the questionnaire will be saved until after the literature review, because designing an effective questionnaire requires an understanding of problems and basic standards for potential solutions. Further, a comprehensive literature review will be conducted first because without it, it will not be probable to conduct the study and interview enough people with enough experience to meet basic standards and certainty for empirical research.

Secondly, why the socio-legal research method will be used since the study feels it is important, is because an evaluation of this kind reflects real problems, real experiences and realistic solutions, and is not just an academic exercise. To obtain a true picture of the financial benefits in the petroleum sector, empirical work will be achieved by soliciting the views of international oil companies, arbitrators, lawyers and solicitors. The analysis of this empirical work will offer valuable insights into the situation and will form the basis of the conclusion of this study. The research will follow the following approach:

- Detailed review of primary and secondary materials: primary sources comprise of petroleum legislation; petroleum contacts and arbitral decision will be reviewed. And secondary materials – these data are collected from books, articles, journals, newspapers, reports, policy papers, conference papers and statistics. These data will be reviewed.
- Conducting an appraisal of oil and gas and other energy contracts and contract provisions determine the extent to which contractual use and the effectiveness in recommending their objectives. It must be recognized that there is a limitation associated with this type of study, which is the confidentiality of petroleum investment contract.

33 *Ibid.*

- Sending questionnaires to persons and organisations known to be active in this field.
- In depth interview with specialist lawyers, as well as energy companies, international petroleum negotiators and law academics.

Questionnaires

Questionnaires are very useful survey tools that allow large populations to be assessed with relative ease. A questionnaire is a set of written questions which is designed for respondents to record their responses.[34] Questionnaires come in different forms, from factual to opinion-based, from tick boxes to free text responses. Whatever their forms, questionnaires are often viewed as quick and easy to do. Survey by questionnaire is the most extensively used data collection method in management research due to its structured data gathering instruments.[35]

The paramount issue in employing a questionnaire survey is to completely understand the question that the research is going to answer.[36] The basic fact is that the information gathered from the survey will be used for either exploratory, descriptive or confirmatory research.

Forza has remarked that the exploratory survey is usually carried out in the early stage of research where the objective is to understand the preliminary idea of the subject. On the other hand, they are focused on recognising phenomena to describe variance.[37] If it is concerned with specific characteristics of a specific population either at a certain time or over varying times for comparison purposes. This kind of survey concentrates on a representative sample of population and the accuracy of findings to draw generalisations.[38]

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[34] Uma Sekaran and Roger Bougie, *Research Methods for Business: A Skill-Building Approach* (6th edition, New York: Wiley 2013) 395.
[35] Put forward by Pareek and Rao (1980) and quoted from Betty Jane Punnett and Oded Shenkar, *Handbook for International Management Research* (University of Michigan Press 2004) 35.
[36] Pervez N Ghauri and Kjell Gronhaug, *Research Methods in Business Studies: A Practical Guide* (Pearson Education 2005) 117.
[37] Cipriano Forza, 'Survey research in operations management: a process-based perspective' (2002) 22(2) International Journal of Operations and Production Management 152-194.
[38] *Ibid.*

Accordingly, survey research, like the other kinds of field survey, can contribute to the advance of scientific knowledge in various ways.[39] Thus, researchers frequently differentiate between exploratory, confirmatory (theory testing) and descriptive survey research.[40]

1. In the preliminary stages, exploratory survey research can help to determine the concepts to be measured in relation to the phenomenon of interest, how best to measure them and how to discover new facets of phenomena under investigation. In due course, it can help to uncover or provide preceding evidence of associations amongst concepts.

2. Confirmatory survey research takes place when knowledge of a phenomenon has been expressed in a theoretical form using well-defined concepts, models and prepositions.[41] In this model, data collection is conducted with the specific aim of testing the adequacy of the concepts developed in relation to the phenomenon of hypothesised linkages amongst the concepts and of the validity boundary of the models.

Prior to starting theory-testing survey research, the researcher has to establish the conceptual model.[42]

Sometimes, the theoretical framework is portrayed through a schematic diagram. Although it is not a requirement, it may be functional for easier communication. Before embarking on theory-testing survey research, the researcher is often obliged to develop a theoretical framework. 'Once the constructs, their relationship and their boundary conditions have been articulated, then the propositions that specify this

[39] Earl R Babbie, *Survey Research Methods* (Wadsworth Publishing Company 1990); Fred Kerlinger, Foundations of behavioural research (3rd edition, San Diego CA: Harcourt Brace 1986).
[40] Alain Pinonneault and Kenneth L Kramer, 'Survey Research Methodology in Management Information Systems: An Assessment' (1993) 10(2) Journal of Management Information Systems 75-105; Roberto Filippini, 'Operations management research: some reflections on evolution, models and empirical studies in OM' (1997) 17(7) International Journal of Operations and Production Management 655-670; and Yogesh Malhotra, *Knowledge Management and Business Model Innovation* (Idea Group Inc 2001).
[41] Forza (n 37) 154-157.
[42] Robert Dubin, *Theory Building* (New York: The Free Press 1978); U Sekaran, *Research Methods for Business* (New York: John Wiley & Sons 1992); M Nacker, 'Telecommunications: benchmarking proven practices' (1997) Credit World 5-17.

relationship amongst the constructs have to be translated into hypotheses relating empirical indicators'.[43]

According to Forza, the common practice is that priority to the researcher planning how to collect data, it is necessary to:

1. define the unit of analysis corresponding to the level of reference of the theory

2. provide and test the operational definitions for the various constructs and

3. translate the propositions into hypotheses.

The matter of the empirical parallel of the level of reference of the theory to the unit analysis

The unit of analysis refers to the level of data aggregation during subsequent analysis. It is important to determine the unit of analysis when formulating the research questions, data collection methods, sample size and the operationalisation of constructs may usually be determined or guided by the level at which data will be aggregated at the time of analysis.[44]

Furthermore, the first difficulty that the researcher faces is in transforming the theoretical concepts into observable and measurable elements in a situation, whereby the theoretical concept is multidimensional, then all of its dimensions have to find corresponding elements in the operational definition.[45] The list of observable elements that constitutes the operational definition of learning are: answer questions correctly, use suitable instances, recall materials after some lapses of time, solve problems and combine materials when necessary.[46]

Consequently, the translation from theoretical concepts to operational definitions can be different from theory to theory. At the same time some theories lend themselves to objective and exact measurements, others are more ill-defined and do not lend

[43] Forza (n 37) 158.
[44] Sekaran and Bougie (n 34).
[45] Forza (n 37) 158.
[46] Sekaran and Bougie (n 34).

themselves to such exact measurements, more so when people's feelings, attitudes and opinions are complicated.

The steps taken in establishing the elements to insert in the operational definition may comprise both contacting those making up the population of interest to gain practical knowledge of how the construct is viewed in actual organisation and identifying necessary precise detail of the industry being investigated.

Hensley has observed that 'the development of items using both academic and practical perspective should help researchers develop good preliminary scales and keep questionnaire revision to a minimum'.[47]

In addition, when the operational definition has been developed, the researcher should test for content validity. The content validity of the construct measure can be defined as the degree to which the measure spans the construct's theoretical definition.[48]

Data can be obtained in a variety of ways, different settings and from various sources. In survey research, the main methods used to collect data are interviews and questionnaires. Interviews may be structured or unstructured. They can be carried out either face to face or over the telephone. Questionnaires can be administered personally, by telephone or mailed to the interviewee.

Each of the various data collection procedures has advantages as well as many downsides. The decision on which procedure is best cannot be made in the abstract; preferably, it should be based on the needs of the precise survey as well as time, cost and resource limitations.

In the situation of mail surveys, questionnaires are printed and sent by mail. The respondents are asked to complete the questionnaire on their own and to send it back. Mailed questionnaires have merits, some of which are: that they save costs, they can be completed at the respondent's convenience, there are no time

[47] Rhonda L Hensley, 'A review of operations management studies using scale development techniques' (1999) 17(2) Journal of Operations Management 343-358.
[48] Manus J Rungtusanatham, 'Lets not overlook content validity' (1998) Decision Line 10-13.

limitations, they can limit interviewer bias and they can also make anonymity certain.

In the case of face-to-face surveys, the interviewer canvasses for information directly from a respondent in personal interviews.[49]

The merits include flexibility in concatenating the details and explanations of the questions and the chance to manage extremely complex questionnaires. There are downsides, however, including high cost, interviewer bias, the respondent's hesitancy to cooperate, greater stress for both interviewee and interviewer. Also, telephone interview surveying comprises collecting information through the use of telephone interviews. Amongst the merits are rapid data collection, lower cost, anonymity, large scale accessibility; the downsides obviously include less control over the interview matters, less credibility and lack of visual materials.[50]

A trend has now surfaced to approach companies and administer questionnaires. The researcher can send a questionnaire through e-mail or ask respondents to visit a website where the questionnaire can be filled in and returned electronically. The merit of minimal cost as compared to other means of distribution is an obvious one.[51] Nonetheless, probable difficulties lie in the sampling and controlling of the environment.[52]

The principal feature of the survey is that it depends on a structured instrument to source information. As soon as the researcher has decided on the content of an instrument, various next steps have to be borne in mind. First and foremost, the ways that questions are asked need to be defined, the scaling of the answers needs to be decided and the questions need to be put into questionnaires that facilitate and motivate the respondents to respond.

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[49] *Ibid.*
[50] *Ibid.*
[51] James E Pitkow and Mimi M Recker, 'Using the Web as a survey tool: results from the second WWW user survey' (1995) 27(6) Journal of Computer Networks and ISDN Systems 809-822.
[52] M H Birnbaum, 'Testing critical properties of decision making on the Internet' (1999) 10(5) American Psychological Society 399-407.

The basic issue is that the actual design of the survey questionnaire is determined by whether it is going to be administered by telephone interview, on site through interview, by email or electronically.

The underlying rule is that when creating the questions, it behoves the researcher to ensure that the language of the questionnaire is consistent with the respondent's level of understanding.[53] In a situation where the questions are ambiguous or interpreted with difficulty by the respondents, the researcher is bound to be flooded with responses that are untrustworthy and biased. In addition, the researcher has to choose between open-ended or closed questions. Closed questions make it easier to obtain fast decisions and make coding easy. However, the researcher has to make sure that the alternatives are mutually exclusive and that, collectively, they consider all the elements.

Also, it is imperative that in creating questions, the researcher should mix positively and negatively worded questions in order to reduce the propensity for respondents to mechanically circle the point towards the end of the scale.

Further, the researcher should use double-barrelled questions with various different questions. Statements that are unclear should be removed completely, as much as practicable. Leading questions should be avoided. In the same vein, questions that are emotionally charged should be removed. Questions should not be worded to generate socially useful responses.[54]

The fundamental rule is that once the questions have been created and their associations to respondents have been developed, the researcher can administer the questionnaire.[55] There are some basic rules that the researcher has to bear in mind: presentability and readability are important for excellent data collection.

[53] Forza (n 37) 168.
[54] See generally Paul Horst, *Personality: Measurement of Dimensions* (Jossey-Bass, San Francisco: CA, 1968); Jean M Converse and Stanley Presser, *Survey Questions. Handcrafting the Standardized Questionnaire* (New York: Sage 1988); and A N Oppenheim, *Questionnaire Design, Interviewing and Attitude Measurement* (New York: Pinter 1992).
[55] See generally, Conserve and Presser (n 54).

To enhance the likelihood of achieving the right goals of data collection, the researcher should meticulously plan the execution of survey research and provide rules on:

1. how sample units are to be approached and

2. how questions are going to be managed.

In recent times, companies and respondents are being asked to complete questionnaires and are becoming elusive about it. Researchers should endeavour to find amicable ways of getting collaboration of companies. Dillman[56] has observed that the response to questionnaires should be seen as a social change and says:

> 1. *Reward the respondent by showing positive regard, giving verbal appreciation, using a consulting approach, supporting his or her values, offering tangible rewards and making the questionnaire interesting;*
>
> 2. *Reduce cost to the respondent by making the task appear brief, reducing the physical and mental efforts that are required, eliminating chances for embarrassment, eliminating any implication of subordination.*

In addition, when respondents understand the rules of a study, lack of anonymity may not be problematic. It makes it easier for the provision of feedback to the respondents, which may serve as an encouragement for participation.[57]

Translating

Translating can change the precise details, wording or meaning of certain questions, so it is imperative to back translate into the original language. Because it was the language commonly read in the most communities, the questionnaire was drawn up in the Ikweire dialect. In a situation where the most common language is not commonly read in the community, the questionnaire would have been verbally translated during enumerator training and translated in real time during

[56] *Ibid.*

[57] Barbara B Flynn, Roger G Schroeder and Sadao Sakakibara, 'A framework for quality management research and an associated measurement instrument' (1994) 11(4) Journal of Operations Management 339-366; and Barbara B Flynn, Roger G Schroeder and E James Flynn, 'World-class manufacturing project: overview and selected results' (1997) 17(7) International Journal of Operations and Production Management 671-685.

questionnaire administration. For this purpose, it is obligatory that a sheet of common or difficult words and their phonetic transliteration be designed to help enumerators in remembering the agreed upon translation of fundamental terms.

Re-testing and Piloting

A pilot study is one of the important stages in a research study. A pilot study is defined as a small study to test research protocols, data collection instruments, sample recruitment strategies and other research methods in a prelude to the launch of the actual research.

Pilot testing ensures that the questionnaire can be clearly understood by the respondents and also it is imperative that it is able to answer the research questions. In addition, pilot testing ensures the reliability and validity of the questions. Furthermore, pilot testing is one of the important phases in a research study and it is carried out to pinpoint problem areas and shortcomings in the research operations and protocol prior to the full study.

1. To ascertain the feasibility of the study arrangement or agreement in this study, a pilot investigation was carried out in Isiokpo Town in Rivers State, Nigeria from June to August 2016. The rules of the study protocol were strictly adhered to. The supervisors enrolled 40 adult males and females: 30 males and 10 females respectively. The health officers and research assistants were well advised as to the procedure and to establish their understanding of the research objectives.
2. The health officers invited respondents to take part in the investigation with sufficient time given to send respondents to whatever they are keen to participate in. The respondents convened showed their consent by signing the consent form. The study was conducted by pre-testing the questionnaire to two types of people: academicians and industrial practitioners. The role of the academicians was to ensure that the questions were able to capture necessary responses to answer the research question. On the other hand, input from the industrial practitioners was also to highlight some areas that might be overlooked by the researcher.[58] According to Forza,

[58] Forza (n 37) 172.

> *In the second phase, the researcher carries out the small pre-test sample to test the contact administrative protocol, to gather data, to perform an exploratory assessment of the measurement quality and to obtain information to better define the same and the adequacy of the measures in relation to the sample.*
> *Also, the pilot testing should resemble as closely as possible the actual survey that will be conducted for theory testing.*[59]

At the end of the pilot testing, the study proceeded with theory testing or the survey questionnaires and the survey administration process since all relevant issues to be re-used had been covered.

Interviews

There are several ways of structuring available approaches to interviewing. This may involve informal and impromptu questions posed in the field.[60] In such scenarios, respondents may be asked to share their own perspectives and experiences. Interviewing may also involve a narrative which refers to storytelling and plot lines; or, focus groups which are concerned with questions designed to provoke interactive answers and debates among multiple participants interviews.[61]

However, it was important to acknowledge that respondents may produce only superficial and cautious responses, given their unique circumstances. Indeed, a deeper understanding of the respondent's circumstances may be required to put their responses into context.[62]

Another perspective on interviews is known as romanticism. According to Dingwell, the nearer we come to the respondent, the closer we are to apprehending the real self.[63] The romantic interviewer may seek to cultivate interpersonal relations founded on a rapport, trust, commitment and warmth between the researcher and

[59] *Ibid.*
[60] Thomas R Lindlof and Bryan Taylor, *Qualitative Communication Research Methods* (2nd edition, Sage Publications Ltd 2002).
[61] *Ibid*.
[62] Jonathan Potter and Margaret Wetherell, *Discourse and Social Psychology* (Sage Publications 1987).
[63] Robert Dingwall, *Context and Method in Qualitative Research* (Sage Publications 1997).

interviewer, to wherein that the latter feels free to express themselves openly.[64]

There has been an increasing recognition that romantics may be persuaded by external influences, wherein the interviewer interprets what he hears in a manner that coincides with his pre-conceived beliefs. As a response, romantics have begun to recognise the importance of establishing close relations with respondents who become participants rather than subjects, to minimise this problem. In this regard, active interviewing may be an ideal form.[65] Notwithstanding, romantic interviews can be difficult to assess precisely because they tend to be context-bound and especially dependent on the dynamics of a particular research relationship and interaction.

The next growing branch of interview worth mentioning is Localism. According to Silverman, localists emphasise that an interview statement must be understood in context, specific to the situation in which it is produced.[66]

Another perspective on interviews is known as Reflexivism. It involves the preparation of the process and not necessarily the content of interview. It has been argued that reflexivism challenges the humanist underpinnings of romanticism in favour of interrogating the politics of interviewing.[67] Also, with this perspective, reflexivism relates to scholarly interviewing as a meta-practice by concomitantly treating it as a comparative cultural and political practice.[68] However, one key problem with reflexivism is that it comprises a tendency to engage in 'confessional analysis that tilts toward self-absorption, where researchers methodically cut up in order to study their own positionality and performance in ways that is unclear rather than inform the broader phenomena at hand'.[69]

It would appear that interview practice has to a great extent, developed from Neo-positivist advice to an increased awareness of the entanglement of the interview set

[64] Sandy Q Qu and John Dumay, 'The qualitative research interview' (2011) 8(3) Qualitative Research in Accounting and Management 238-264.
[65] Jaber F Gubrium and James A Holstein, *The New Language of Qualitative Method* (Oxford University Press 1997).
[66] David Silverman, *Interpreting Qualitative Data: Methods for analysing talk, text and interaction* (3rd edition, Sage Publications 2006).
[67] Gillian Symon and Catherine Cassell (eds), *Qualitative Organizational Research: Core Methods and Current Challenges* (Sage Publications 2012) 244.
[68] *Ibid.*
[69] *Ibid.*

of circumstances.[70] The work sought to adopt elements of these perspectives to bring out the best productive talk from respondents and participants.[71] According to Alvesson and others, 'without a theoretical understanding supporting critical judgement, any use of interview materials risk naively and leaves interpretations poorly grounded simply put, technique is important but cannot stand alone; discussions of good practice are framed on term of the deeper epistemological orientation at hand'.[72]

Another question that readily comes to mind is, who is to be interviewed? By way of an answer, two guiding principles should be adhered to. The first is to identify a representative, in order to account for some coverage of a social category. The second is to aim for quality in the interview responses. Alvesson and others observed that 'well-selected interviewees can be quite helpful but sometimes researchers will become inclined to reply heavily on those to whom they have ready access or who are simply to themselves on terms of values and other identity feature'.[73] As such, it is necessary for researchers to strike a balance between utilising quality responses and responses that are true to the particular context.

Furthermore, it is achievable to integrate different design elements, degrees of structure in a single research project. Matts and others explain that 'one option is to start with a set of open-ended interviews in order to refine the focus and conduct of the study. After, an exploratory phrase will follow; wherein the researcher might produce more specific set of questions. A reverse logic could also work beginning with standardise questions to get an overall 'Lay of land' and later, selecting some time themes for a fuller exploration in more open in-depth the interviews'.[74]

To sum up, given the various perspectives and methods, it cannot be overstated that interviews are carried out time and again with little reluctancy. Its use will continue to play a vital role in legal research and practice.

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[70] *Ibid.* Neo-positivism typically involves a high degree of structure, while romanticism favours openness and relational flow over rigidity.
[71] A Fontana and J H Frey, 'The interview: From Natural Stance to Political Involvement' in N K Denzin and Y S Lincoln (eds) *The Sage Handbook of qualitative Research* (Sage Publications 2005).
[72] Mats Alvesson, Karen Lee Ashcraft and Robyn Thomas, *Identity Matter: Reflections on the Construction of Identity Scholarship in Organization Studies* (Sage Publications 2008).
[73] *Ibid.*
[74] *Ibid.*

Research techniques

The use of qualitative research techniques will be adopted in this study. Qualitative research uses a naturalistic approach and seeks to understand phenomena in context-specific settings, such as real world setting where the researcher does not attempt to manipulate the phenomenon of interest. Patton states that 'both qualitative and quantitative researchers need to test and demonstrate that their studies are credible. Thus, it seems when quantitative researchers speak of research validity and reliability, they are usually referring to a research that is credible while the credibility of a qualitative research depends on the ability and effort of the researcher'.[75]

Further, after composing a working definition of the production sharing contract and the joint venture, the thesis will advance to a more detailed analysis of the legal nature and fundamentals of such petroleum agreements.

1.4.3 Models to appraise socio-economic impact of oil exploitation

1.4.3.1 Gravity allocation models

First, and foremost, gravity allocation models are used widely for investigating settlement patterns of energy-related workers. These models take it as a central principle that larger communities nearer to project sites will gain more population from the project than lesser, further inaccessible ones.[76]

1.4.3.2 Investigation of inputs and purchasers of products

Another device frequently employed in assessing the secondary effects of a preliminary economic incentive on an area's employment, income, and output is an investigation of the inputs, on the one hand, and the purchasers of products, on the

[75] Michael Q Patton, *Qualitative Research and Evaluation Methods* (2nd edition, Thousand Oaks, CA: Sage Publications 2002) 39.
[76] Steven H Murdock and Larry Leistritz, *Socioeconomic Impact of Resources Development: Methods of Assessment* (Boulder, CO: Westview Press 1981).

other hand. This offers the basis for outlining the multiplier effects of a dramatic development of petroleum activity in the economy.[77]

1.4.3.3 Other survey techniques, case studies and analyses

Finally, some studies have adopted survey techniques useful to understanding the social and economic impact of energy-associated development on a community.[78] The methodology used to carry out this study is basically a combination of national case studies and comparative and theoretical analyses. The examination and analysis will also be predicated on the principle that the constructive and objective interpretation of the constituent documents of the contracts will assert the individual host countries' legal rights and affirm the legal validity of the terms of the contract. Rather than making the terms less equitable, the legal approach is therefore likely to guarantee the principles of justice, fairness and procedural due process.

1.4.3.4 Sampling procedure:

In this study purposive sampling is used to focus on particular characteristics of a population that are of interest. According to Burns and Groves, 'the target population is the entire aggregation of the respondents that meet the designated sets of criteria'.[79] The target population of this study is consequently the oil workers operating in Nigeria that are involved in production sharing contract and joint venture operations with the national oil company NNPC, there are basically 10 of such companies which together with NNPC constitute the target population. The main goal of purposive sampling is to focus on particular characteristics of a population that are of interest, which will best able to answer the research questions. One of the main benefits of purposive sampling is the wide range of sampling techniques that can be used across such qualitative research designs:

Qualitative research designs can involve multiple phases, with each phase building on the previous one. In such cases, different types of sampling technique may be required at each phase. Purpose sampling has a downside, notwithstanding the type

[77] F Larry Leistritz, Steve H Murdock and Robert A Chase, 'Socioeconomic Impact Assessment Models: Review and Evaluation' (1982) 1(4) Impact Assessment Bulletin 30-43.
[78] Michael Gibbons and Roger Voyer, 'Technology Assessment: A Case Study of the East Offshore Petroleum Exploration' (1974) 30 Science Council of Canada Background Study.
[79] Nancy Burns and Susan K Grove, *The Practice of Nursing Research: Conduct, Critique and Utilization* (3rd edition, WB Saunders Company, Philadelphia 1997) 226.

of purposive sampling used, it can be extremely prone to researcher bias.[80] The idea that a purposive sample has been created based on the judgement of the researcher is not a good defence when it comes to alleviating possible researcher biases, particularly when compared with probability sampling techniques that are designed to reduce such biases.[81] Nevertheless, this judgemental, subjective component of purpose sampling is only a major disadvantage when such judgements are ill-conceived or poorly; considered that is, where judgements have not been based on clear criteria, whether a theoretical framework, expert elicitation, or some other accepted criteria.[82]

The subjectivity and non-probability-based nature of unit selection i.e., selecting people in this study as the oil industry; purposive sampling means that it can be hard to defend the representativeness of the sample.

1.4.3.5 Data collection:

For this study, both primary and secondary sources of data collection have been relied on. The primary data was obtained from the senior officers of the oil companies involved in the joint venture and production sharing contracts through the questionnaires. The questionnaires were intended to be as simple as possible for the easy understanding of all the respondents concerned. It contained personal data information and information relating to joint venture and production sharing contracts management processes, performance and technology application and investment risk. Personnel interviews with selected employees were also carried out to supplement the questionnaires.

Secondary sources included International Legal instruments, decided cases, Conventions, Treaties, national legislation, model concessional and contractual legal instruments, Joint venture Agreements and Production Sharing Contracts. The main substance of this legal research is therefore based on books, judicial decisions, journals and opinions of courts of competent jurisdiction; the United Nations Charter and the UN General Assembly Resolutions; the Vienna Convention on the Law of Treaties, general principles of law, soft laws, including various countries' constitutions and on the opinion of other researchers. The decided cases are the

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[80] E Dhivyadeepa, *Sampling Techniques in Educational Research* (Laxmi Book Publication 2015) 113.
[81] *Ibid.*
[82] *Ibid.*

judicial decisions of national and international courts on Joint venture, production sharing contracts, foreign investments, international trade disputes and host countries vs multi-national companies' contractual conflicts. Other secondary sources include monographs, news bulletins, oil production reports, newspapers and magazine publications as well as materials sourced from the internet. These materials shall be subjected to context and contextual analysis to achieve both the broad and specific objectives of the study.

1.5 SCOPE AND LIMITATION OF STUDY

The scope of this study is the analytical legal study of joint venture and petroleum sharing contracts in less developed oil-producing countries especially Nigeria and some selected jurisdictions, the attendant conflicts raised by such contractual arrangements, its impact on the host countries and their citizens, the workability, functionality and sustainability of the sharing arrangement contracts, legal consequences in case of breach and way forward to making more effective and workable production sharing agreements that protect the interest of both contractual parties, the growth of the oil industry and their operating environment.

In achieving this study's objective, I have paid visits to the Shell headquarters in Nigeria, the Mobil Production Facilities and their regional offices in United Kingdom, China and Ghana, including the headquarters of OPEC in Vienna, Austria for the purpose of using their library to research primary documents and engage in discussions with their staff. However, these visits took place a considerable time ago and it has not been possible to revisit for updating purposes in this regard, as access to these establishments and to United Nations resources has been restricted since the 11 September crisis, thus limiting the research in terms of recency of figures and substantial access to primary data, but in spite of these, this research will be conducted with the available data information, resources and secondary data comprising the work of distinguished published authors.

In a similar vein, endeavours to carry out legal research in Nigeria stumble upon several formidable obstacles. Firstly, there is no institutionalised public distribution of Nigerian statutes or regulations, hence it is almost impossible to find complete sets of laws or to remain abreast of recent developments, more so that most of the enabling laws are obsolete due to lack of legislative review. Secondly, there are no official translations of Nigerian local laws and customs or regulations into English; The recent increase in foreign investment has prompted a surge of interest in Nigerian legal matters which has unconscionably raised the cost of legal publications.

Furthermore, for this particular study, an important impediment was the general isolation of production sharing and joint venture contracts. Possibly the most serious obstacle to legal research in Nigeria is the astounding degree of variance between laws and administrative conduct. The loose construction of many principal laws enables administrative officials to exercise considerable discretion without unswervingly contravening any legal prohibition. Likewise, many decisions made by government officials acquire the force of law through enduring practice but are never publicly recorded. I therefore could not disregard anecdotal information wholly because of an absence of documentation. However, discussions with the staff of such establishments were indeed quite useful in the course of this research work.

1.6 JUSTIFICATION OF THE STUDY

This study will promote a better understanding of the legal basis of the various developments in the area of the dynamics of entering into oil-production sharing contracts in the selected less-developed countries. Also, it aims to shed light on the rising conflicts in such contracts, assist in reducing the conflicts, raise awareness on the modalities of operational agreements in the oil industry and how they can affect the host countries' sovereign power over their natural resources, reduce their expected revenue and adversely affect the industry's growth and operating environment, suggest the way forward for creating a mutually beneficial oil-production sharing agreement including the insertion of legal safeguards to protect the parties' interests.

Particularly, this research will also enlighten the oil industry, the legal community and the general public on the emerging issue of oil-production sharing agreement disputes and ways of addressing them in the identified jurisdictions of Nigeria and other selected less-developed oil-producing nations. This research therefore hopes to make meaningful contribution to the understanding of law, legal contracts and state-corporation agreements in relation to Petroleum production, extraction and distribution of profits in Nigeria and other similar countries' oil industry.

1.7 SIGNIFICANCE OF STUDY

The practice of entering into concession contracts, joint venture and production sharing agreements by less developed countries is a burning, contemporary and very controversial issue. It has led to breakdown of contractual economic relationships, attraction of trade sanctions on host countries of foreign investor's investments through unlawful expropriation and non-payment of compensation, diplomatic rows and estranged relationship of host countries and transnational corporation's parent countries, fostered corruption practices and loss of substantial revenue for developing countries. Thus, this study will highlight the reasons some of these less developed countries of the world exercise caution in going into oil-production sharing contracts with multi-national oil companies and the increasing desire of these countries to empower their state oil companies to take-over their oil production, distribution and commercialisation from the multi-national companies.

This study will further shed light on the ways these contracts can be entered into more peacefully and harmoniously. It would equally help in the better understanding of the basis for entering into or refusing to enter into oil-production sharing contracts by the identified less-developed countries and to form a basis of precedence in designing such contracts for similar transactions in other jurisdictions of the world. The study would therefore become a useful material in the field of oil and gas law and expands the discourse on the contractual and legal relationship between multi-national oil companies and their host countries with their attendant issues and the law on one hand and would help in the better formulation of law for heralding the formation of the contracts and making more robust contractual agreements that best suits the interests of both contractual parties and their operating environment on the other hand.

1.8 OUTLINE OF CHAPTERS AND PLAN OF STUDY:

The present (first) chapter explores the introduction to the conceptual framework of the study, the background to the study and the statement of the problem to be addressed by this research work. It clearly sets out the research questions to be answered in this treatise, the objectives of study, elucidates the legal issues to be analysed in the thesis and the arguments supporting them, most of which are based on the moderate legal analytical concepts and philosophical approach of the realist school of thought; sets out the research methodology, the scope and limitation of study, the plan of study, the significance of study and the justification of study.

Chapter 2 firstly examines the joint-venture, discusses its origin, definition of the joint venture, nature, types, reasons and background and analysing the general scheme set out. Secondly, it examines the wide variety of factors which made this form of business operation into a more propitious and viable proposition than the old concessions, in terms not only of a company's internal development but also in response to the changes in the oil sector and the economic climate.

Chapter 3 discusses joint operating agreements, their nature, purpose and terms, as applicable to the Nigerian oil sector. The joint operating agreement defines the rights duties and other obligations of the joint venture partners in respect of a particular leased or licensed area. It spells out the legal relationship between the partners, lays down rules for the joint development, and procedures for the development of the area concerned and of the jointly owned enterprise by the partners. This chapter further examines the memorandum of understanding (MOU), which arose when, with the oil glut of the mid-eighties, the Nigerian official selling price (OSP) for crude oil became unrealisable in the world market. The price of oil plummeted to record lows, discouraging further investment. The government quickly responded to this development to obviate further dwindling of oil revenue which contributed a large chunk of the nation's foreign exchange earnings by introducing an incentive package better known in Nigerian legal parlance as MOU. The package was designed to stimulate investment in exploration and production activities and to encourage the export of Nigerian oil.

Chapter 4 discusses the production sharing contract, its origin and subsequent development. This form of financing arrangement is becoming increasingly popular. The basic idea behind production sharing contracts was the requirement for redeemable fixed interest loans to be made by transnational companies to the Indonesian government. Under the Indonesian-styled PSC, the foreign investor was considered a creditor rather than a partner or contractor. For the arrangement to be of significant benefit to the host country, the government must be able to readily sell its share of the output of the extractive operations in domestic or foreign markets.

The PSC financing arrangements will not generate significant shifts in the allocation of financial benefits. However, in industries where bargaining power continues to shift in favour of the host country, and where host country negotiation skills are adequately strong, the changes will be more than political. There will be real changes in who controls the operations and who receives the financial benefit from the project.

Chapter 5 examines Nigerian production sharing contracts, past and present. The Nigerian PSC differs in certain respects from the standard PSC which was pioneered in Indonesia.

In Chapter 6, the question of renegotiation clauses is examined. A number of issues relevant to the question of the renegotiation of international petroleum agreements are dealt with in this chapter. Such issues include: the question of how such clauses can contribute to the stability of the international petroleum agreements; problem areas of renegotiation clauses; renegotiation in the absence of a renegotiation clause, and other related issues. This is followed by an examination of the effect of such clauses as articulated by the petroleum arbitral practice. In addition, the validity and the effect of stabilisation clauses is examined. Further, this chapter examines, the choice of law clause. In this area of law, several theoretical problems which arise from the participation of state governments or their constituent entities in international oil contracts remain unresolved. Opinions have become polarised, with respect to several issues, principally the severability doctrine and issues of applicable law. Also, this chapter deals with the controversial question as to the nature of compensation for expropriation of foreign property. There is a general acceptance that compensation must be paid. The Hull Rule Standard of full compensation seems to have amassed support principally in bilateral treaties but the alternate standard of appropriate compensation is still vigorously propounded by its adherents. Available evidence suggests that there has been an effort to transfer the emphasis onto the valuation standard but these efforts do not detract from the fact that the matter of the standard of compensation has to be settled first.

Chapter 7 examines the relative objectives of the host country and the multinationals. The necessity for petroleum leads to different strategies by various countries dependent on whether they are developed or developing countries, exporters or importers. Developing countries are mainly importers and place a lot of emphasis on ensuring security of supplies and not being dependent on any one source. They are also concerned with increasing or at least maintaining their reserve levels. On the other hand, the exporting developing countries with substantial oil deposits are eager to ensure effective control over their petroleum resources and to maximise the revenue accruing. The revenues retained by the state are or should be used to realise the policy objectives of the state and to ensure that the activities of the oil industry complement these policy objectives.

Chapter 8 draws conclusions and makes a set of recommendations that can assist every stakeholder to adopt a most mutually beneficial production sharing contract that will take into cognisance the interests of the contracting parties and that of the inhabitants of their operating environment.

The traditional concession, the predecessor of the joint venture, endured for about half a century as the exclusive institutional framework defining the commercial and legal relationship between energy-producing countries and international oil companies. According to Gao, "the early concession regime was based on power politics and a "big oils" policy rather than partnership and cooperation. As such, the concession regime accorded the major oil companies virtually absolute freedom to conduct petroleum operations in the conceding states. Governments had little control over either their resources or the companies operating within their territories".[83] The principle of mutuality of interests was not conserved under the concessions by host-country governments for a more equitable sharing of the gains, and it was ultimately necessary to go through a range of phases of renegotiation, revision, nationalisation, and eventual termination, in order to reinstitute the principle.

The traditional concession agreements in general failed to develop a balanced, assiduously stable and mutually beneficial relationship between the contracting parties. Concerns for natural resource conservation and sustainable development were not articulated at all during this development. The third quarter of the last century not only witnessed widespread baulking at the old concession system, but

[83] Zhiguo Gao, *International Petroleum Contracts: Current Trends and New Directions* (1st edition, Kluwer Law International 1994) 20.

also saw a firm emergence of new contractual arrangements.[84] This transition from traditional concession agreements to modern petroleum contracts has been viewed by some developing countries as a "revolutionary process" which would ultimately restructure the legal relationships between governments and companies in the years to come.[85]

The fact remains that the old agreements were concluded in conditions of gross discrepancy between the bargaining positions of the host countries and the oil companies. The companies very nearly dictated their terms and secured for themselves agreements they could neither substantiate nor defend in later, more progressive days. The financial benefits they obtained were unparalleled – so much so that the oil business became by far the most lucrative ever known in the world.

More importantly, the control they exercised over their host-countries' primary (in some cases, only) source of livelihood, was inordinately excessive, which placed those countries' economies at their mercy and gave them powers which amounted to serious encroachments on the states' sovereignty. Oil policy making was their preserve; they decided levels of production, prices and of course exploration programmes, with scant regard for the states' rights to have a say in such matters. In short the host countries, apart from the stipulated financial returns, did not enjoy any of the rights and privileges that should rightfully be theirs by virtue of their being the owners of the oil.

In light above, this shows the one-sidedness of the old agreements and partly explains the later developments that took place to correct the situation. The state-within-a-state position which the companies secured for themselves was to lead to their undoing. The producer countries became increasingly alive to the realities of the situation and step by step started taking back what rightfully belonged to them.

From the foregoing, in order to understand the need for entering into joint venture and production sharing contracts by multi-national oil companies with less-developed host countries, it is important to explain the definition and characteristics of joint venture, how joint venture compares with partnership, and the rationale for joint ventures.

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[84] Robert Fabrikant, *Oil Discovery and Technical Change in South-East Asia: Legal Aspects of PSCs in the Indonesian Petroleum Industry* (Singapore: Institute of Southeast Asia Studies 1973) 21.
[85] *Ibid.*

CHAPTER 2

JOINT VENTURE AGREEMENT

2 .1 INTRODUCTION

The joint venture as a form of business organisation is deeply rooted in the past, however, the legal principles of joint ventures are of relatively recent development.[86] Some legal forms still employed in the world today were surprisingly well developed long before the Christian era.[87]

The concept of joint venture as a legal relationship or association *sui generis* is a creation of the American courts dating back from about 1890. In ancient Egypt, Syria, Phoenicia, and Babylonia, the joint venture was used to conduct sizeable trading and commercial enterprises.[88] It is on record that at the height of the Roman Empire, when a great concentration of wealth was needed, an organisation in the nature of joint venture was employed. In Venice, for instance, a form of joint venture was employed for the purpose of joining all the shareholders in the ships of a fleet principally for the purpose of making joint purchases and sales on definite voyages.[89]

With the passing of time and with the growth of commerce and trade in Western Europe, business associations, including the joint venture, were adopted and enhanced. Some metropolitan countries such as Italy, France, Germany and The Netherlands made the most of some forms of joint venture practices. This form of business organisation ultimately spread to England, which had in earlier times what was referred to as the joint adventure. With the expansion of commerce, the need for greater concentration of capital and the desire for distribution of risk were cogent factors creating the need in England for a type of organisation such as the joint venture. It would appear that in most of these countries, they developed some sort

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[86] See *Glaser v Medford-Marlboro Knit Gaiter Co* (1944) 93 NH 95, 36 A 2d 280; *Albert Pack Corp v Fickling Properties (1941)* 146 Fla 362 200 So 907; *Werrberger v Mejunklin* (1935) 171 Okla 528 43 P2d 729; *Fairbanks Morse & Co v District Courts* (1933) 215 Iowa 703, 247 NW 203 *Lesser v Smith (1932)* 115 Conn 86 160 Ad 302.
[87] Henry Nichols, 'Joint Ventures' (1950) 36 Virginia Law Review 426.
[88] Miriam Beard, *A History of the Business Man* (New York: MacMillan Company 1945).
[89] Shephard B Clough and Charles Woolsey Cole, *Economic History of Europe* (3rd edition, Boston: DC Heath 1952); Joseph Adalbert Dewe, *History of Economics: Or Economics as a Factor in the Making of History* (New York: Benzinger Brothers 1908); Herbert Heaton, *Economic History of Europe* (New York: Harper & Brothers 1936); Frederic C Lane, 'Family Partnership and Joint Ventures in the Venetian Republic' (1994) Journal of Economic History 178.

of joint venture practice. Likewise, in America, the concepts of joint venture as a business organisation were brought to the United States with the commerce from England.[90]

In recent years, however, joint ventures have come to involve both blue chip companies and their more modest counterparts; they traverse most industrial and commercial sectors; they bring into relationship companies within an individual country, as well as linking companies across the national frontiers.[91] They assist in the building of bridges between business organisations which have reached a mature stage of technical competence, and those with lower level of technology; between those who have marketing resources, business expertise and financial muscle and the innovators; and those who have an urgent need to rationalise and bring about order in their market places.[92] It can be argued that the basic concept of joint venture arises in some industries as a saviour, in others as the harbinger of a brighter business future, and in some as a defender of the national birth right.[93]

Individuals, partners and even corporations have joined, or attempted to join, in what they had called the joint ventures for the purposes of pooling capital and carrying out large industrial and financial projects.[94] By pooling their resources, plants and personnel, they demonstrate their joint ability to perform and provide capital sufficient to warrant their undertaking the job. Joint venture alliances and collaboration agreements are now being entered into on an unprecedented scale, with US companies forming thousands every year.[95]

Often however, joint ventures do appear to rest uneasily between the legal constructs of partnership and contract. In many ways, the joint venture can function as a partnership, even though it lacks many of the fundamental elements of it. Thus, there are considerable questions on this subject, especially whether the joint venture activity is a business carried on in common and whether the agreement to divide the fruits of the activity, gives it a view to profit.

[90] For further details regarding the origin of joint venture, see Nichols (n 87) 426-429; W H Jaeger, 'Joint Ventures part I: Origin, Nature and Development' (1960) 9(1) America University Law Review 2-5.
[91] The Financial Times quoted from John Walmsley, *Handbook of International Joint Ventures* (London: Graham & Trotman 1982) 1.
[92] *Ibid.*
[93] *Ibid.*
[94] Nichols (n 87) 428.
[95] *Ibid.*

This chapter will examine the joint venture arrangement: the underlying principles, origin, definition, types, advantages and disadvantages of a joint venture. The thesis will further examine the objectives of the joint venture in relation to exploration and production arrangements. Also, a comparative study of joint ventures and partnerships will be carried out. In addition, the thesis will proceed to demonstrate in more detail the variations that exist in different parts of the world; the basic elements of the mineral and petroleum joint venture will also be established.

2.2. DEFINITION OF JOINT VENTURE

A joint venture has been defined as "an association of persons with intent, by way of contract express or implied, to engage in and carry out a single business venture for joint profit, for which purpose they combine their efforts, property, money, skill and knowledge, without creating a partnership or a corporation, pursuant to an agreement that there shall be a community of interest amongst them as to the purpose of undertaking, and that each joint venturer shall stand in the relation of principal, as well as agent, as to each of the other co-venturers, with an equal right of control of the means employed to carry out the common purpose of the venture".[96]

Young and Bradford remarked that a joint venture is "an enterprise, corporation or partnership formed by two or more companies, individuals or organisations, at least one of which is an operating entity which wishes to broaden its activities for the purpose of conducting a new profit-motivated business of permanent duration. In general, the ownership is shared by the participants with more or less equal distribution and without absolute dominance by one party".[97]

Crommelin provided a practical description of joint venture in the mineral and petroleum industry. He succinctly states:

> *The mineral and petroleum joint venture is an association of persons (natural or corporate) to engage in a common undertaking to generate a product to be shared amongst the participants. Management of the undertaking is divided: specified activities are to be performed by a designated person (the operator or manager) as agent for the*

[96] *Johanik v Des Moines Drug Co* (1945) 235 Iowa 679 17 NW 2d 385. See also Nichols (n 87) 431.
[97] G Richard Young and Standish Bradford Jr, *Joint Ventures: Planning and Action* (New York: Financial Executive Research Foundation 1977) 3.

participants; the power to determine certain matters is vested in a committee (the operating or management committee) upon which participants are represented and entitled to vote in accordance with their interests in the venture; and other matters are decided at the outset by the participants as terms of the association. The relationship among participants is both contractual and proprietary: the terms of the association are fixed by agreement, and property employed in the undertaking is held by the participants as tenants in common[98]

It would seem that the mineral and petroleum joint venture, unlike a corporation, does not enjoy a legal personality. Sometimes, confusion is bound to occur as a result of terms such as "incorporated joint venture", referring to a company formed by participants in a common undertaking as a vehicle for that undertaking, the participants being the stakeholders of that company with their relationship defined by a shareholders agreement.

As a legal concept, this type of association has been slow to develop and has had a difficult struggle to obtain a legal character of its own. Although the legal significance of the joint venture has come to be recognised, no decisive and uniform definition of the joint venture agreement has yet been established nor is it possible to enunciate a general rule by means of which the question as to what amounts to a joint venture can be answered. This is because such an answer depends largely on the terms of the particular agreement in question; upon the construction which the parties have given it; upon the nature of the undertaking, as well as upon other facts.[99]

According to Berg, Duncan and Friedman, most joint ventures are borne out of sets of unique circumstances.[100] They also draw attention to the fact that they represent an organisational form for achieving economic objectives which neither parent could normally attain acting alone. However, Dunning is of the view that in 1982,

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[98] Michael Crommelin, 'The Mineral and Petroleum Joint Venture in Australia' (1986) 4(2) Journal of Energy and Natural Resources Law 65-66.

[99] Nichols (n 87) 430; The Organization for Economic Co-operation and Development (OECD) corroborated this opinion in their publication about joint venture by stating that "the specialist literature gives many definitions…although none provides a truly definitive answer," C Nightingale and Adrian Montague, *Joint Venture* (Sweet & Maxwell 1990) 1-7; Crommelin (n 98) 79, also stated that "the joint venture has provided the vehicle for huge investments in exploration for and production of natural resources in Australia in spite of the inescapable uncertainty surrounding its legal attributes. It remains for the courts to place their stamp of approval upon this creature of commercial ingenuity"; See also Jaeger (n 90) 1-2.

[100] S V Berg, J Duncan and P Friedman, *Joint Venture Strategies and Corporate Innovation* (Cambridge MA: Oelgeschlager, Gunn and Hain 1982) 37.

corporative agreements formed between the United States and foreign companies, outnumber the number of fully-owned subsidiaries by a factor of at least 4 to 1. In his words, "the world's leading multinational enterprises are operating through an intricate global web of formal and informal coalitions, most of which are in the advanced industrial countries. This development induced the formation of oligopolistic galaxies with the major world producers at the hub of the galaxies".[101]

Furthermore, some cases have defined the joint venture as an association of persons to carry out a single business enterprise for profit, for which purpose they combine their property, money, effects, skill and knowledge; each participant therein an agent for each of the others, and each has control of the means employed to carry out the common purpose.[102]

One court describing the joint venture in concise terms stated that "a joint adventure, we think, exists when two or more persons combine in a joint business enterprise for their mutual benefit, with an express or implied understanding or agreement that they are to share in the profits or losses of the enterprise, and each is to have a voice in its control and management".[103]

In Scots law, for instance, the term apparently refers to a variety of partnership, one confined to a definite transaction or series of related transactions. Accordingly, it is defined as "a species of association in trade analogous to, or perhaps more correctly a variety of, partnership in which the partners use no firm or social name although they are associated in joint adventure or trade which is confined to a particular adventure, speculation, course of trade or voyage."[104]

In the United States of America, the law is no different. However, Williston puts forward a radical view, in which he states: "A joint venture is an association of persons, natural or corporate, who agree by contract to engage in some common, usually *ad hoc* undertaking for joint profit by combining their respective resources, without, however, forming a partnership in the legal sense (of creating that status) or corporation; their agreement also provides for a community of interest among the

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[101] John H Dunning, *The Globalization of Business (Routledge Revivals): The Challenge of the 1990s* (Routledge 2015) 191.
[102] *Johanik v Des Moines Drug Co* (n 96).
[103] *Chison v Gilmer* (1936) 81 F 2d 120, 124, 4 cir.
[104] *Encyclopaedia of the Law of Scotland* 11 (1931) s 67 at 32 and *Bell's Principles* 392; cited in J A Samuels, 'Brian Pty Ltd v United of Dominion Corporation Ltd' (1985) 59 ALJR 676-681.

joint venturers, each of whom is both principal and agent as to the other within the scope of the venture over which each venture exercises some degree of control."[105]

This position has received judicial support in Australia. The definition of joint venture came up for consideration in the case of *United Dominion Corporation Ltd v. Brian Pty*.[106] The main issues that were canvassed in this case were whether UDC had acted in breach of a fiduciary obligation owed to Brian in obtaining the collateralisation clauses in the mortgages with the result that these clauses were unenforceable against Brian. The dictum of the High Court on the meaning of "joint venture" is instructive in this regard; Mason, Brennan, and Deane gave dissenting judgments:

> *The term 'joint venture' is not a technical one with a settled common law meaning. As a matter of ordinary language, it connotes an association of persons for the purpose of a trading, commercial, mining or other financial undertaking or endeavour with a view to mutual profit, with each participant usually (but not necessarily) contributing money, property or skill. Such a joint venture (or, under Scots' law, 'adventure') will often be a partnership. The term is, however, apposite to refer to a joint undertaking or activity carried out through a medium other than a partnership, such as a company, a trust, an agency or joint ownership. The borderline between what can properly be described as a joint venture and what should be more properly be seen as no more than a simple contractual relationship may, on occasion, be blurred. Thus, where one party contributes only money or other property, it may sometimes be difficult to determine whether it is a joint venture in which both parties are entitled to a share of profits or a simple contract of loan or a lease under which the interest or rent payable to the party providing the money or property is determined by reference to the profits made by the other.*[107]

It would appear that this description contains some contrary implications for the mineral and petroleum joint venture. A project on international business ventures was carried out by a Colombia Law School team headed by Professor Friedman, and

[105] United Dominions Corporation Ltd v Brian Pty Ltd [1985] HCA 49; (1985) 157 CLR 1.
[106] *Ibid* 506.
[107] *Ibid* 679.

they came to the conclusion that "in the widest sense, the term joint venture comprises any form of association which implies collaboration for more than a very transitory period."[108] More narrowly, the joint venture has been defined as an association of two or more natural or juridical persons to carry on as co-owners an enterprise or venture, or operations for the duration of that particular transaction or series of transactions or for a limited time.[109]

Lastly, the joint venture may be defined as a corroboration of an existing or new investment involving shared ownership between local and foreign partners. The parties to a joint venture may be individual corporate bodies, governments or government agencies and the agreement may be bipartite or multipartite. [110]

Ultimately, the term joint venture has been most frequently interchanged with the partnership concept.[111] Originally, joint ventures were assimilated to partnerships and were treated as a "special"[112] or "limited"[113] or even an "informal"[114] form of that type of association. It was in the latter half of the nineteenth century that the American courts began to recognise the distinction between the two concepts.[115] To this day, however, some courts seem to regard them as synonymous.[116] Other courts have viewed joint ventures as similar to partnerships but not identical.[117] Other jurisdictions are of the view that the joint ventures are not quite a partnership but are to be governed by partnership law.[118]

The distinguishing features of a standard joint venture arrangement are: firstly, that the participants hold their interests in the assets of the venture in common and their liability is several; secondly, that an operator or manager is interposed between the

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[108] Wolfgang G Friedmann and George Kalmanoff, *Joint International Business Ventures* (New York: Columbia University Press 1961) 6.
[109] Joseph Taubman, *The Joint Venture and Tax Classification* (New York: Federal Legal Publications 1957) 83; Joseph Taubman, 'What Constitutes a Joint Venture?' (1956) 41 Cornell Law Quarterly 641.
[110] Wolfgang G Friedman and Jean-Pierre Beguin, 'Joint international business ventures in developing countries' (1971) 13(3) The International Executive 20.
[111] For example, it is well documented that the term 'joint venture' was not recognised under English common law, yet it was adopted by judges in England and the Commonwealth. See F L Mechem, 'The Law of Joint Adventure' (1931) 15 Minnesota Law Review 644, 644-668.
[112] *Lesser v Smith* [1932] 160 A 302.
[113] *George W Haxton & Son v Rich* [1944] NY App Div 47 NYS 2d 501.
[114] *Lesser v Smith* (n 112).
[115] Walter H E Jaeger, 'Partnership or Joint Venture' (1961) 37(2) Notre Dame Law Review 138, 141.
[116] *Ibid* 141; *Porter v Cooke* [1942] 317 US 670.
[117] *Ibid* 142.
[118] *Costa v Borges* (2008)145 Idaho 353.

participants and the operation; and thirdly that the participants receive the fruits of the venture separately and in kind.

2.3 JOINT VENTURE AND PARTNERSHIP COMPARED

Partnership has been defined in Anglo Australian parlance as the relationship which subsists between persons carrying on a business in common with a view to profit.[119]

There is a growing controversy as to whether it is necessary for the statutory definition of a partnership that the profits are divisible amongst the persons who carry on the business,[120] but the resolution of this question need not hinder us in seeking to inform ourselves of the legal character of a joint venture. If what is done in common produces profits, there is no doubt that they are divisible amongst the participants. The significant questions are whether the joint venture activity is a business carried on in common and whether the agreement to divide the fruits of the activity, be they prospects proved or product won or treated, gives it "a view to profit". It would be hard to uphold a contention that a joint venture formed exclusively for prospecting or exploration and which required separate arrangements to be made for the exploitation of discoveries, was either a business or an activity with a view to profit.

The basic fact is that where the common activity is the working of a mine or a well, however, a further element is present. The product is not fixed capital but stock for consumption or sale. If a participant were to conduct the whole operation alone from extraction, through treatment to sale, in common parlance he would not be said to be conducting three businesses. If he were to join with another for the purpose of selling the product, the separation of that activity from production would make them different businesses, at law, for accounting and for taxation. Combination for production which is not followed by a separate transaction of sale independently of the product by the parties so grouping themselves is fundamentally dissimilar.

Despite the fact that the parties acquire the individual's business of selling, that business is not separate from the activity of production. He does not obtain his stock

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119 The Partnership Act 1890 was adopted shortly after its enactment by most developing countries like the Australian colonies. See for example, Uniform Partnership Act (1997) <www.uniformlaws.org/shared/docs/partnership/upa_final_97.pdf> accessed 20 June 2018.

120 See *Pooley v Driver* [1876] 5ChD 458 [472]. This case was decided before the promulgation of the Act. The court came to the conclusion that there could not be a partnership without there being a commercial business to be carried on with a view to profit and for the division of profits.

by purchase and the selling phase of the total activity that is carried out in common is not a separate rewarding activity.[121] An arrangement to provide a facility, such as a treatment plant or a railway, for gain may be a partnership, notwithstanding the parties' desire that it should not be. The previous cases that recognised that the ownership of income-producing property together with agreement about management did not amount to a partnership[122] are given statutory acknowledgment by the rule that joint tenancy, tenancy in common, joint property, common property or part ownership does not of itself produce a partnership as to anything so held or owned, whether or not the owners or tenants share any profits made by the employ thereof.[123] There is no partnership because there is no business. However, if the co-owners' actions extend beyond the sheer ownership of property and the obligatory passive management to the ways of a business, it is hard for them to oppose characterisation as a partnership.[124]

2.4 PREVALENCE OF PARTNERSHIP

It is essential to the formation of partnership that in dealing with outsiders every partner has authority to act on behalf of the partnership and to bind the other partners.[125] The scope of a partner's authority is confined by the extent of the partnership business and the relationship of a particular transaction to it and by agreed limitations upon the partner's authority to act on behalf of the firm. Other partners are bound only by a partner's acts for carrying on in the usual way business of the kind carried on by the firm.[126] Express limitations on a partner's authority relieve his partners from liability for his acts only if the person with whom he is dealing either knows that he has no authority or does not know or believe him to be a partner.[127]

Also, it is basic for the conception of partnership that each partner is liable, jointly with the other partner(s) and jointly and severally for loss or injury caused to an outsider or for a penalty incurred by the wrongful act or omission of any partner acting in the ordinary course of the partnership business or with the authority of the

[121] Partnership Act (n 119) Section's 9 and 10.
[122] See *French v Styring* [1857] 2 CBN S 357.
[123] Partnership Act (n 119) Rule 1.
[124] J D Merralls, 'Mining and Petroleum Joint Ventures in Australia: Some Basic Legal Concepts' (1980) Australian Mining and Petroleum Law Journal 1, 3.
[125] Partnership Act (n 119) Section 5.
[126] *Ibid.*
[127] Partnership Act (n 119) Section 6.

other partners.[128] The partners may agree amongst themselves to distribute the burden differently, but their agreement does not bind outsiders who deal with the partnership even with knowledge of its existence. Individual partners cannot obtain limited liability by notice.[129] A judgment creditor may levy execution against the separate property of one of the partners. The partner has only a right to be indemnified by his partners in the agreed proportions. The pledge of assets to a partnership does have legal consequences for creditors if the partnership becomes bankrupt. The claims of partnership creditors must be satisfied out of the partnership assets before those of the partner's separate creditor. Execution cannot be levied against the separate interest of a partner in partnership assets, but provision has been made by statute for obtaining an order charging a partner's separate interest in the partnership property and profits.

Before the Partnership Act 1890, a separate judgment creditor was entitled to levy execution against a debtor partner's interest in the partnership and for that purpose was entitled to an account between the debtor and his partners. Under the procedure instituted by the 1890 Act a charging order has the upshot of an equitable charge given by the debtor partner; nevertheless, an additional order must be obtained to give effect to the charge by the appointment of a receiver and, in exceptional conditions, the taking of accounts and investigation between the chargee creditor and the other partners. The other partners are at liberty at any time to cash in an interest that has been charged or, if the court directs sale, to purchase it; they may also break up the partnership.

The agreement also has significance in relation to dealings by outsiders with the firm because it determines whether assets that are used for the purposes of the partnership are partnership property, and hence assets primarily available for partnership debts, or the separate property of individual partners. In the absence of opposing agreement, the interests of partners in partnership property and their rights and duties in relation to the partnership are resolved by statutory rules: -

a) all parties are entitled to share equally in the capital and profits and are liable to contribute equally to the losses;

[128] Partnership Act (n 119) Section 9.
[129] See Partnership Act generally (n 119) Sections 16 and 17.

b) the partnership is liable to indemnify each partner for payments made and personal liabilities incurred by him in the ordinary and proper conduct of the business or in anything necessarily done for the business or property of the partnership;
c) a partner making, for the purpose of the partnership, any payment or advance beyond the amount of capital he has agreed to subscribe is entitled to interest from the date of payment of advance;
d) a partner is not entitled, before the ascertainment of profits, to interest on the capital subscribed by him;
e) each partner may take part in the management of the partnership business but
f) none is entitled to remuneration for acting in the partnership business;
g) no person may be introduced as a partner without the consent of all the existing partners;
h) any differences arising as to ordinary matters connected with the partnership business may be decided by a majority but unanimity is required to change the nature of the partnership business. Where a partnership is not for a fixed term, it is terminable by any partner at will; the partners are obliged to render accounts of the partnership business and full information to any partner; partners may not contend with the firm; the court may decree that the partnership be wound up in particular conditions.[130]

Further, occurrences of the relationship are imposed by law. Two are vital:-

i) a partner has no title to specific property owned by the partnership but has a *chose in action* against all the other partners which entitles him to require the partnership property to be applied for the purposes of the partnership business during its currency and in its termination to receive a proportion of the net surplus of the assets after legal responsibilities are satisfied;[131] and
ii) a partner owes a fiduciary duty to the other partners in relation to the partnership business. These matters are recognised in the Partnership Act but they derived from the application of commonplace legal and equitable

[130] Partnership Act 1890 (n 119) Sections 19, 24, 26, 28, 31, and 35.
[131] Halsbury, *Laws of England* (4th edition, volume 6); *Federal Commissioner for Taxation v Everett* (1980) 6(54) ALJR 196, 197-198.

principles to the relationship of partners. They are intrinsic in the relationship.[132]

An appropriately drawn joint venture agreement will categorise the assets that are to be used in the venture and apportion share in them. It is frequently declared that those assets are owned by the participants as tenants in common in the proportion of their defined share. (In some joint ventures, predominantly exploration ventures, assets committed to the venture remain the property of some parties to the exclusion of others. Special provision has to be made for those assets in the agreement. What is more, it is not compulsory for all the assets that are dedicated to a joint venture to be owned by the participants in the same proportions). The agreement binds the participants to assign the assets to the venture and by and large provides for their management and control.

2.5 CHARACTERISTICS OF A JOINT VENTURE

Joint ventures are not created by the operation of law.[133] A joint venture is usually born out of a contract, either express or implied. The *sine qua non* of a joint venture is a contract purposefully entered into by the parties.[134] As a legal concept, the joint venture is not a status imposed by law, for instance an agency, but is a relationship voluntarily assumed and arising wholly *ex contractus*.[135] As is true of other contracts, it would seem that the contract need not be express, integrated, or, if in writing, contain all the details. [136] It is a settled principle of law that where there has been active participation in the venture, and also where a reasonable degree of control over the property or other subject matter involved is present, the conduct of the parties and other facts and circumstances may well justify the court in inferring the existence of a joint venture.[137]

Since it is like any form of contract, all the elements of a contract such as offer, acceptance, capacity of the parties, lawful object, and consideration or a seal must

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[132] Merralls (n 124) 5.
[133] George William Miller, 'The Joint Venture: The Problem of Child Partnership' (1950) 38(5) 860, 862; See also Nichols (n 87) 432.
[134] *Hyman v Regenstein*, 285 F 2d 502 (CA) 5.
[135] *Carboneau v Peterson*, Wash 2d 347, 95p2d 1043.
[136] See Samuel Williston and Walter H E Jaeger, *A treatise on the law of contracts* (3rd edition, Baker Voorhis 1957).
[137] *Nelson v Abraham*, 29 cal 2d 745, 177p 2d; See also Jaeger (n 90) 140.

be present.[138] The joint venture is usually created only if the parties intend to enter into such arrangement. Once the contract has been established, the rights and duties of the parties will be determined by law and it is, of course, unnecessary for the parties to enter into a special formal agreement to engage upon a joint venture.[139] As in the case of other contracts, a failure of one joint venturer to carry out his contractual duties where non-performance is not excusable will constitute a breach of contract.[140]

There are certain elements which one comes across regularly enough in legal publications and cases to be considered as fundamental factors in the joint venture. It cannot be said with certainty that the joint venture will fail if any one of them is lacking.[141] A number of these elements recurrently appear in the joint venture, no one of which, standing alone, is deemed sufficient to create the relationship. The features most regularly encountered are:

(a) An enterprise which brings the participants together, i.e. a community of interest shared equally or otherwise by all participants.
(b) A motive, generally profit, which moves the participants to embark upon the enterprise.
(c) An agreement between the participants containing all the essentials of a legal contract. This contract may be written or implied.
(d) A clear arrangement for the management of the joint venture, with or without joint control on the part of the participants.
(e) Intention of the parties as to motive and enterprise is important. Unless this is a clear part of the contract, the joint venture may fail.
(f) Clear profit sharing arrangement in those enterprises embarked upon for profit.[142]

[138] *Ibid* 144.
[139] *Ibid.*
[140] *Ibid.*
[141] In *Petty v First National Bank of Quitman* [1955] Tex Civ. App 278 SW.2d 364. The courts alluded to the difficulty in attempting to define partnership by stating 'There is non fixed definition of a partnership; therefore there can be no fixed form of pleading to allege same… that elements usually appearing in partnerships are present in facts disclosed here, that is 1) a common undertaking; a venture for profit; common control; each party participating in profit and losses.
[142] Nichols (n 87) 433.

2.5.1 Business purpose

It is a fundamental feature of any joint venture that it is entered into for the prosecution of some particular business enterprise, or the pursuit of a specific line of trade.[143] Only those associations or enterprises created for commercial purposes are by and large deemed within the purview of joint ventures.[144] The parties must intend to join their property and efforts in furtherance of some enterprise.[145]

The lack of any business relationship or objection has been considered adequate to repel an inference that a joint venture exists.[146] According to Nichols, 'in this connection social accommodations, courtesies and functions occurring during the course of a situation place no constraint upon the courts in reaching the conclusion that a joint venture transaction exists. Therefore, where there has been no financial or business interest involved, most courts are reluctant to find a joint venture relationship'.[147] Thus, the joint venture concept must be confined to those transactions partaking of the nature of an association to carry out a business enterprise.[148]

The law requires little formality in the creation of a joint venture.[149] In evaluating whether or not such a relationship exists, the courts are guided not only by the spoken or written words of the parties, but also by their acts.[150]

There must be an agreement to enter into an undertaking in which the parties have a common purpose.[151] Sheer accompaniment in a project or coordinated action taken by two individuals and performed concomitantly does not meet these requirements, no matter how intimately joined.[152] There must be entrance into mutually binding obligations to envisage a joint venture and it must in due course rest on a contract.

In view of the fact that the joint venture is contractual, it is advisable that the relationship should be evidenced by written agreement.[153] If the joint venture

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143 *Ibid.*
144 *Ibid.*
145 *Ibid.*
146 *Ibid.*
147 *Ibid* 434.
148 *Ibid;* Nelson v Abraham [1947] 29 Cal 2d 745, 177 P.2d 931.
149 *Ibid.*
150 *Ibid.*
151 Nichols (n 87) 435.
152 Brown v Wood [1940] 293 Mich 148, 291.
153 Nichols (n 87) 435.

relation is left to be established by oral agreement, such an oral agreement rests on the recollections of the parties who may, with all honesty, differ in their recollections of what was said as to the terms and conditions of the agreement.[154]

No fastidious form of expression is obligatory to create the relationship of joint venture, and it has been held that where a corporation and an individual come together in a specific venture for joint profit, such arrangement may constitute a joint venture notwithstanding the description of one of the joint venturers as a partner.[155]

Since in all contracts, the intent of the parties is essential, the joint venture arises only where the parties to an undertaking intend to enter into such an arrangement. The first question in establishing a case of joint venture is to find out the intention of the parties *inter sese*.[156] In giving a ruling on the intention of the parties, the courts are governed by the literal rules relating to the interpretation and construction of contracts.[157]

2.5.2 Joint interest

The underlying principle of the joint venture is open, non-secret dealings between participants: in other words, a fiduciary relationship requiring paramount good faith.[158] It is sacrosanct that there must be in existence a community of interest between the parties to the transaction.[159] Consequently, a pooling of funds for purchase for accounts is not a joint venture. There is no joint account or stock. In *Charles Hasday et al v Morris Barocas et al*[160] the court held that "therein intention is paramount. There must therefore subsist more than the mere unity of possession of tenants in common".[161] The mere action taken in concert is not essentially expressive of a community of interest.[162] Contributions of money, sharing of expenses, rendering of services, sales assistance, participation in management, all performed

[154] *Ibid.*
[155] *Twyford v Sonken-Galama Corp* [1936] 177 Okla 486 60 p 2d 1050.
[156] *Bryce v Bull* [1932] 106 Fla 336 [343].
[157] Nicholas (n 87) 435.
[158] *Ibid* 438.
[159] *Birnbaum v Kirchner* [1949] 337 Ill. App. 25, 85 NE.2d 191.
[160] *Charles Hasday et al v Morris Barocas et al* [1952] 10 Misc 2d 22.
[161] A C Freeman, *Co-tenancy and Partition: a treatise on the law of co-ownership as it exists independent of partnership relations between the co-owners* (2nd edition 1886) 150.
[162] *Alexander v Turner* [1941] 139 Neb 364, 297 NW 589.

jointly, have been considered evidence of a community of interest existing between the participants in a joint venture.[163]

Despite that several cases have affirmed "community of interest", an essential element of any joint venture, few courts have explained the terms. However, in Carboneau v Peterson an extensive analysis of the term "community of interest" was stated:

> *"Next there must be a community of interest in the performance of the purpose. While this element is usually connected, and often identified, with the purpose to be accomplished, it is nevertheless, a distinct factor. The parties may have a common objective or purpose, and still a community of interest may be lacking. For instance, two parties may be engaged in the performance of a purpose or object, which may be for the sole interest or advantage of one, and from which the other is to derive no benefit whatever, or the interest of the one may be different and distinct from that of the other; in either of such cases there would not be a joint adventure. The term "community of interest" as applied to the relation of joint adventure, means an interest common to both parties, that is, a mixture or identity of the interest in a venture in which each and all are reciprocally concerned and from which each and all derive material benefits and sustain a mutual responsibility".*[164]

2.5.3 Joint control

The most imperative criterion of a joint venture is joint control or management of the property employed in realising its aims. In deciding whether joint ventures subsist in a particular transaction, most jurisdictions claim that some element of joint participation in the management or conduct of the enterprise or right of mutual control be present.[165] Joint venturers, in general, have equal voices and control in the operations of the enterprise.[166] The parties thereto tend to possess an equal right in the management and conduct of the undertaking; such right is noticeable in the power of each member to determine particularly how, when and where the details of

[163] *In re Asiatic Exploration* [1930] SD Cal, 41 F 2d 230; Quoted from Nichols (n 87) 438.
[164] *Carboneau v Peterson* [1939] 1 Wash 2d 347 375 95 p 2d 1043 [1055].
[165] *Balestrieri & Co v Commissioner* [1950] 9th Cir 177 F 2d [867].
[166] *McElwee v Curtis-Wright Corp* [1947] ED Mo 70F Supp [97].

the enterprise are to be performed.[167] Even though a joint venture may consider an equal right on the part of all persons engaged in an undertaking to have a voice in the leadership and management of the venture, the courts are aware of the right of the participations to surrender their control to one or more of the parties without changing the statutes of the joint venture.[168]

There is no agreement on this point. Other courts have declared that while a joint venture usually relates to a single transaction, it may comprehend a business to be continued for a period of years.[169] In other cases, where certain undertakings were adjudicated joint ventures, numerous transactions extending over prolonged periods of time have been involved.[170] There are various authorities to the fact that a joint venture may consist of one or more transactions.[171] Clearly, a commercial undertaking, transaction or business may consist of one act, or may involve numerous dealings or affairs, related or unrelated to one another.

Furthermore, it would seem that in a joint venture *laissez choisir* is subject to the limitation, that were the success of the venture be jeopardised by the withdrawal, the court will permit the venture to continue to completion. A joint venture for an undefined term terminates at will.[172]

2.5.4 Profit and Losses

In Commercial Lumber Co v Nelson, it was observed that "a profit jointly sought in a single transaction by parties thereto is the main characteristic of a joint venture".[173] Similarly, in Horning Inc v McAleenan, it was held that '"he well settled definitions of a joint adventure unequivocally include the element of profit seeking".[174] There must be the sharing of adventure by the associates, i.e. the seeking of profit with its correlative obligation of sharing of losses.[175] Whenever money or labour is jointly contributed to obtain or construct property for personal use but not for profit, the courts have held that no joint venture relationship ever existed.[176] Nor will a joint

[167] Nichols (n 87) 440.
[168] *Seymour v Wildgen* [1943] 10th Cir 137 F 2d [160].
[169] *Johanik v Des Moines Drug Co.* [1945] 235 Iowa 679 NW 2d [385].
[170] *McKee v Capitol Diaries Inc* [1940] 164 Ore 1, 99 P 2d [1013].
[171] *In re Gotfried* [1942] SD Cal 45 F Supp 939; *Dolan v Dolan* [1928] 107 Conn 342, 140 Atl [745].
[172] *Dugan v Pettijohn* [1955] 285 P2d 339.
[173] *Commercial Lumber Co v Nelson* [1937] 181 Okla 122, 124, 72 P 2d [829], [830].
[174] *Horning, Inc. v McAleaenan* [1945] 4th cir 149 F2D [561], [566].
[175] Taubman (n 109).
[176] *Binning v Miller* [1940] 55 Wyo 478 102 p2d 64.

venture be created where each party to an enterprise profits in his own way without sharing any common or joint profit.[177] The principle issue in this instance is that the profit accruing must be joint and not several, as otherwise every person, firm, or individual who has any connection with the enterprise might be termed a joint adventurer therein, whether they had any such intention or not.[178]

It would seem that an enterprise undertaken for profit is one of the key factors involved in any joint venture, but in and of itself it may be inadequate to ascertain the existence of the relationship. The courts have held in *Marston v Gould* that "a share in the net profit is an interest in the profits and implies a participation in the profits and losses."[179]

There are a gamut of authorities to the effect that one of the obligatory factors in proving a joint venture is the responsibility of the parties to it for losses as well as their right to share in the profit.[180] Accordingly, even though there is no express provision for the sharing of losses, one may be implied.[181] Whether expressly stated or implied, an essential ingredient in the association in a joint venture is sharing of both profit and losses.

2.5.5 Capital Contribution

One fundamental test in deciding whether a joint venture is said to exist is whether there has been contribution by all the parties to the common undertaking.[182] There must be some contribution by each co-venturer participating in the enterprise. This contribution may be in the form of property, money, efforts, skill or knowledge. The responsibility of each of the parties may differ in amount, depending upon the terms of the agreement. The contributions need not be of the same character. In one situation adjudicated a joint venture, one participant agreed to provide a farm and purchase and sell all livestock, feed and farm products, and the other party contributed his labour to the undertaking. Where a party is apparently associated

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177 *Jarvis v Sun Chemical Corp [*1947] SDNY 7 FRD 50.
178 *Minnetonka Lumber Co, 103 Okla 226, 229 Pac.*
179 *Marston v Gould* [1899] 69 NY [220], [223].
180 Stoddard v Goldenberg [1941] 48 Cal App 2d 319, 119 P 2d [800].
181 Cf NY Partnership Law 11(4), 40 (2); *Van Tine v. Hilands*, 131 Fed. 124 (SDNY 1904). It has been held that loss does not necessarily mean actual loss of money, but it may be a loss in expenditure of time. *Sunners v Hoffman* [1955] 341 Mich 686, 69 NW 2d [198].
182 *Hathaway v Porter Royalty Pool* [1941] 296 Mich 90 295 NW 571 (1942); *Rae v Cameron*, 112 Mont 159, 114 P2d [1060].

with other joint ventures, but fails to contribute to the undertaking, such failure results in his omission from consideration as a participant in the venture.[183]

Furthermore, funds have to be found for the common activities and participants agree to contribute them.[184] It is not uncommon for participants to be given cross charges over each other's interest to secure the performance of the obligations to contribute funds. If the cross-charges have priority over mortgages or charges to third parties, a third party's own security will be subject to the charges of the participants other than his own mortgagor and he will take the benefit of his mortgagor's cross-charges without innovation.[185]

2.6 REASONS FOR A JOINT VENTURE

The main reasons why industrial companies may wish to consider a joint venture are not farfetched. Primarily, the main attraction of a joint venture as a business tool is the clarity of purpose that arises as a precondition to its existence.[186] For instance, an individual company may have lost its sense of direction when a practical examination of any set of business plans will demonstrate how easily chief executives and their staff can lapse into the role of merely maintaining long-standing company traditions, practices, and structures. Participation in a joint venture, by contrast, forces attention onto a dominant business purpose.[187]

Furthermore, another important reason for the attractiveness of a joint venture is the fact that it often possesses a number of comparative strengths over other possible routes to the various business improvements that are desired.[188]

Observers such as Walmsley, are of the view that where an organisation's strategic interests lie outside a purely internal readjustment, there are a number of hypothetically cooperative options available.[189] These may include joint venture,

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[183] *Highland Sales Co v Robertson* [1939] 104 Colo 22, 90, P2D.
[184] It is worth noting that such observations apply especially to development and facility joint ventures and most probably less to ventures for exploration. In exploration ventures it is most common to find the contribution of some participants to be in cash and for others in kind in the form of prospecting rights.
[185] See generally, Merrals (n 124) 907; and Michael Coyle, 'Australian Joint Ventures and the Cross Charge' (1991) 11(3) AMPLA Bulletin 122. A cross charge is essentially an adaptation of the equitable charge whereby each joint venture participant grants an equitable charge over its share in the joint venture assets, in favour of its co-participants.
[186] Walmsley (n 91) 3.
[187] *Ibid.*
[188] *Ibid.*
[189] *Ibid.*

merger, or acquisition. In this case, an important distinction can be drawn that is not a matter of semantics.[190]

Consequently, embarking on a joint venture operation might be interpreted as a deliberate decision to achieve new business strength without the use of a merger or acquisition strategy based on the advantages of such a decision in terms of risk.[191] It would appear that the joint venture affords the maximum opportunity to control and develop a structure which is consistent with clearly stated purpose. If it chooses, it can adopt its own style and there is no need whatsoever to assimilate inherited business strategies, and it has no resistance to overcome within its own infrastructure[192] .

Further, a joint venture need not contain any winners or losers;[193] however it should and can harmonise the varying skills that the partners are able to contribute in the interest of the joint business mission. With regards to business development, the joint venture operation is so clearly isolated from the existing structure of the participants that both sides can measure the activity created and react in a way that is often not possible in the context of a merger or an acquisition situation.

It has been further remarked that the joint venture may also provide the best and sometimes only realistic route for gaining entry to new emerging markets in areas such as Europe and Asia, where access to local knowledge or sponsorship knowledge is a practical necessity.[194]

Further, international joint ventures can provide the most effective route for a party to expand the scope of its customer base by utilising a co-venturer's strength in different geographic markets or by buying in to a co-venturer's distribution or sales network.[195]

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[190] The word cooperation has been deliberately emphasised, because two businesses cooperating through a third entity are a joint venture whereas incorporating another into itself is a merger or an acquisition.

[191] *Ibid 4.*

[192] *Ibid* 4.

[193] *Ibid* 5.

[194] Ian Hewitt, *Joint Ventures* (1st edition, Pearson Professional Limited 1997) 1.

[195] Walmsley (n 91) 5.

Similarly, another important reason for a joint venture is that it contains an inherent flexibility.[196] The fact is that they can be moulded and shaped in different ways to suit the specific needs of the partners and the market.

Furthermore, firms, whether small, medium, or large scale, may be too small in relation to a particular project to raise adequate capital to undertake that activity on an individual basis.[197] By pooling resources with other firms, it becomes relatively easier to finance such huge projects or obtain such venture capital due to their increased ability to repay loans and provide the necessary collateral.[198] The inability of participants to provide such collateral would have being inimical to getting loans, for instance, in sectors like resource exploration and development, and in certain advanced technology sectors.[199] In addition, research and development, natural resources exploration and large construction and engineering projects are types of joint venture in which even large enterprises may cooperate to reduce risk.[200] For instance, in the oil and gas industry, exploration activities are usually beset with low success rates and such projects involve the expense of huge sums of capital which individual enterprises cannot contemplate. It is trite law that in industries where economies of scale are substantial, joint ventures, and particularly the vertical joint venture, may produce substantial distributional and transnational savings.[201] In most cases, such a limited integration of this kind may be preferred, with the parent firm establishing a subsidiary rather than an outright merger of all the firm's operations because this is a more flexible arrangement capable of being ended if it does not meet expectations or if circumstances change.[202]

Similarly, another reason that may be adduced as to why enterprises may opt for a joint venture is to overcome entry barriers to product markets, especially in areas of highly concentrated markets or those protected by trade and investment barriers against foreign competition.[203] The fact is that often the foreign enterprises are able to associate themselves with domestic firms to circumvent such barriers. In addition,

[196] *Ibid.*
[197] Organisation for Economic Co-operation and Development, *Competition policy and joint ventures* (Paris, France: Organisation for Economic Co-operation and Development; Washington DC: OECD Publications and Information Centre 1986) 19.
[198] *Ibid.*
[199] *Ibid.*
[200] *Ibid.*
[201] *Ibid.*
[202] OECD (1986) (n 197) 20.
[203] *Ibid.*

a joint venture may also be motivated by the desire to increase market power or to avoid competition, whether such competition is either actual or potential.[204] However, such power may be exercised on both the buyer's and the seller's side of the market.[205]

According to the OECD, considerations of a legal or political nature play a central role in the creation of a joint venture.[206] Competition authorities are more tolerant towards joint ventures than they are to cartel-type arrangements between firms.[207] Joint ventures also constitute an important vehicle for international investment, especially in countries where, for political reasons, a degree of domestic participation is a prerequisite for the setting of operations, for instance, in Nigeria under the indigenisation decree of 1978.

Another plausible reason why firms engage in joint ventures is that "firms tend to expand by mergers acquisitions or internal development into areas directly related to their current sphere of operations, either complementary or supplementary. However, they have a store of ideas, knowledge or know how that is a spin-off of their current activities without being a complement or supplement to them…In short, the joint venture is a feasible organisation because it allows fuller use of a firm store of knowledge for the exploration of new areas of endeavour that the firm could undertake on its own only at higher resource cost or with a rising marginal cost of internal coordination".[208]

Further, a joint venture may be a preliminary step for "an eventual disposal or acquisition of a business with a further tranche of the disposal or acquisition being contemplated, although perhaps not specified, for a later period".[209]

Furthermore, it could be a catalyst for change.[210] For example, a situation could arise where the parties to the joint venture may wish to bring in another party or even change the business activity.

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204 *Ibid.*
205 *Ibid.*
206 *Ibid.*
207 *Ibid.*
208 *Ibid* 21.
209 Smriti Chand, 'The Foreign Manufacturing Strategies with Direct Investment' (2018) < www.yourarticlelibrary.com/international-marketing/the-foreign-manufacturing-strategies-with-direct-investment/5858> accessed 20 June 2018.
210 *Ibid.*

The joint venture is a convenient means for providing a greater concentration of finance and managerial resources, knowledge and skill essential to the accomplishment of large scale construction projects such as oil exploitation. Backman says that, "joint ventures are formed for a variety of reasons. The joint ventures are not seeking partners merely to share profits. Rather they are formed because each of the partners has a contribution to make, either in terms of technical know-how, marketing know-how or financial or other resources. The main advantages of the joint venture are widely recognised. They are used to: (1) unite diverse technical abilities of different industries; (2) expand new sources of raw materials; (3) surmount local discrimination against foreign corporations or make use of the resources of local enterprises overseas; (4) coalesce a range of raw materials with knowledge as to how to convert them into multifaceted finished products; (5) broaden the risk and thus smooth the progress of raising capital; (6) acquire economies of scale in production and marketing; (7) generate new products; (8) mingle the scale techniques of one company with the production know-how of another; (9) achieve technical resources beyond the capacity of single companies."[211]

In addition, the Organisation for Economic Cooperation and Development (OECD) observed that "the reasons American businesses choose to enter joint ventures include: (1) the desire to spread the risk in rather speculative projects or in projects in an unstable area; (2) the need to raise large sums of capital or credits; (3) the need for the skills or marketing experience possessed by other businesses; (4) the necessity or political advisability of having local interests associated with foreign investment and (5) a requirement of local governments that they or their interest in any business established by the foreign investor."[212] They went further to suggest that "the following more theoretical explanations have been given for the increased popularity of the joint venture: (1) the magnitude and integrated complexity of today's major commercial projects; (2) the advent of governments as buyers and sellers in the economic field and (3) the growing habit of cooperation in a society that is growing crude competition and laissez-faire concepts."[213]

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[211] Jules Backman, 'Joint Venture and the Anti Trust Laws' (1965) 40 New York University Law Review 651-52.

[212] 'International Joint Venture Corporations: Drafting of Control Arrangements' (1963) Duke Law Journal 516.

[213] *Ibid.*

In the developing countries, from an economic point of view, one basic reason for setting up a joint venture is to make use of complementary technology and research activities.[214] Most governments are seen to favour joint ventures on the grounds that they permit local capital to participate more fully in the benefits of economic development and that they transmit technical and business know-how more rapidly and effectively than either purely local or 100 per cent foreign owned ventures.[215] In addition, joint ventures lessen the danger of foreign domination of the industry. Such a joint venture usually involves firms from different industries or different segments of the same industry cooperating in order to acquire knowledge they do not possess.[216] It invariably means that the joint venture may serve as an important tool for transferring technology.

Furthermore, in the post-war period, when balance of payment problems were severe in most developing countries, their governments were concerned, from time to time, that any immediate benefit to the balance of payment arising from the inflow of foreign capital would be more than counterbalanced in the long run by the outflow of dividends.[217] Thus, in most cases, this has been a major reason for preferring joint ventures, since the burden of dividend transfers and the repatriation of foreign capital is thus abridged, by and large, whilst still acquiring the gains in the acquisition of techniques and the management skills.[218]

Friedman and Kalmanoff have favoured the view that "less developed countries insist on joint ventures with government participation because of lingering misgivings about foreign investment and the fear that it may put forth an unacceptable political and social impact. An unreceptive minority partnership for the government may be adequate to assuage anxiety, since their representatives sitting on the board are in a better position to examine the activities of the business and to make known its intentions appropriately than would be an external group of officials to whom the business might otherwise have to report. Further, it would appear that the persistent use of joint ventures may reflect the yearning to preserve the opportunity for the local business interests to share in the lucrative industries designated by foreign

[214] Friedman and Kalmanoff (n 108) 131.
[215] *Ibid.*
[216] *Ibid.*
[217] *Ibid;* Studies have shown that the net growth of the economy arising from such foreign investment has been sufficient to improve the net balance of payments through import substitution or new exports.
[218] *Ibid.*

investors for exploitation. Where the market for the given product is too small to allow more than one large plant sufficient scope to earn the benefits of the device, there is a strong attraction to pre-empt, by government pronouncement, a place for the local business interests by insisting on the joint venture form of business whether or not this is the judicious path for speedy development".[219]

2.7 ADVANTAGES OF THE JOINT VENTURE

A very important advantage for the joint venture is a limitation of the investment requirement.[220] According to Kolde, this can be attractive *per se* but, more particularly, this may particularly be the case when the investment is made in a country with either existing or potential exchange control problems affecting possible repatriation.[221]

Another advantage may well lie in overcoming national limitations in a country where joint ventures are proposed by foreign-owned businesses or restricted outright or are subjected to prior approvals which is difficult to obtain except where it is of obvious advantage to the country.[222]

The most apparent advantage is the limitation of the risk of failure of the enterprise.[223] The party tendering for a large contract may wish to mitigate his risk of failure by subcontracting.[224] Herzfeld and Wilson argue that "where a joint venture is entered into to introduce a product into a country by local manufacture, the investment of the foreign party may largely comprise the transfer of industrial property rights and of technological know-how and, in addition, the supply of machinery and of components, with the total further contribution coming from within the country".[225] This invariably reduces the financial risks for the foreign contractor.

Walmsley has remarked that joint venture provides a reasonable means of crossing ethnic, cultural and business frontiers at one and the same time, through the cautious selection of local partners; and secondly it encourages modernisation and

[219] *Ibid* 132 (Emphasis added).
[220] Endel J Kolde, 'International business enterprise' (1968) 10(3) The International Executive 271.
[221] *Ibid.*
[222] Staffan Gullander, 'Joint Ventures in Europe: Determinants of Entry' (1976) 6(1/2) International Management 85, 90.
[223] Edgar Herzfeld and Adam Wilson, *Joint Ventures* (3rd edition, 1996) 25.
[224] *Ibid.*
[225] *Ibid.*

inventiveness harnessed to a common business goal.[226] At a time, when many other forms of company development are essentially being hushed by free enterprise structures, joint ventures offer a way out of that problem which centres around the predisposition of businesses to grow and amalgamate, and in so doing develop a lifestyle of their own, which is not always favourable to risk-taking and capitalist action.[227]

The lifeblood of the future, that is, the resourcefulness and modernisation inherited through the first industrial revolution, which should keep reputable manufacturers ahead of recently developed competitors, is at best at risk, and at worst often undeveloped.[228] Joint ventures are subsequently, not only a means for the renewal of companies, but also "an important lifeline" [229] for the continuous existence of the Western manufacturing economies.

Both sides could also secure the benefits of efficient production resources in very depressed markets. Only time will tell if the deal will come through with all the benefits envisioned, but in theory the joint venture solution provides a malleable tool for both sides in the framework of a defensive policy.

2.8 DISADVANTAGES OF THE JOINT VENTURE

Management style: In broad terms, joint control means joint decision-making and to many top executives the sharing of decisions does not necessarily come easily.[230] It should be acknowledged that this intricacy goes beyond the barely defined subject of decision-making and concerns all issues affected by what is known as management style. There is also evidence that even the composition of the joint venture's board may pose a huge challenge. Obviously, if it is to function efficiently, its members must be able and willing to attend the majority of its meetings. In a large corporation, this may not augur well, since this may mean excluding the top cadre from the board and this might be displeasing to some members and throw doubt on the degree of obligation.

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[226] Walmsley (n 91) 8.
[227] *Ibid.*
[228] *Ibid.*
[229] *Ibid.*
[230] *Ibid.*

It will be obvious that in any joint venture, conflicts of interest may arise between the participants and between the interests of one or other participant and those of the joint venture. In fact, to Roulac, "some of these may not be obvious to all parties".[231] It has been suggested that one such situation could be where one participant might look for benefits that would come to him rather than to the joint venture. Indeed, participants may well be looking ahead to what they can achieve on premature termination of a joint venture, an attitude sometimes described as 'competitive collaboration' or 'takeover by stealth'.[232]

2.9 EFFECT OF FAILURE OF A JOINT VENTURE

The major problem upsetting joint ventures is consideration of the possible consequences of failure. It will be understandable that a participant who had earlier decided in favour of a joint venture in preference to available alternatives will not wish to find that after a limited time he is faced with just one or other of those alternatives, principally if that now entails total loss of control because he cannot, for whatever reason, obtain control himself.[233]

According to Herzfeld and Wilson, "in some circumstances, the fact that a business is operated as a joint venture may, particularly in the early stages, tend to concentrate the limelight on it and probably to show larger start-up expenses than would have been the case under the umbrella of an existing organisation where some expenditures might never have been charged to the business. Whether this is to be considered a positive or negative aspect may depend as much on the outlook of the different participants as on any strictly objective measure, but participants should take cognizance of it in judging a joint venture's results".[234]

In a large number of conditions, joint ventures are not the first choice of either party. The options that are available are subject to a wide range of issues. The main issue in the decision must be the nature of the business venture.

In practice, it is obligatory to be aware that the enforcement of intellectual property rights and other equivalent arrangements comes up progressively more against

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[231] Stephen E Roulac, 'Structuring the joint venture: Mergers and Acquisitions' (1980) 15(1) Spring Publication 4.
[232] See *The Financial Times* (1 February 1989) 32.
[233] Herzfeld and Wilson (n 223) 28.
[234] *Ibid.*

various forms of anti-monopoly legislation and as a result is becoming less certain in its dependability. A joint venture in research and development may also come about as an appropriate way for the participants to resolve a conflicting exclusive rights situation.[235] In particular, Houlder points out "teaming up with a stronger partner to improve skills or gain access to new technology or products is a risky strategy, as it usually results in the weaker partner being acquired by the stronger one".[236] Furthermore, in circumstances where the participants are large corporations, it is necessary and desirable for the joint venture to have a long-term sponsor in each participating corporation.[237]

2.10 THE OBJECTIVES OF THE JOINT VENTURE AGREEMENT

The objectives of each joint venture are basically the same. However, the terms and conditions vary somewhat from one agreement to another. Under this kind of arrangement, exploration plans are to be prepared and implemented, either directly by the foreign partner or through the agency of an operating company. Exploration should be to the maximum possible extent and in conformity with good oil field practice, and periodic progress reports should be submitted to the National Company.[238] Usually the foreign partner provides the capital at its own risk and is committed to spending agreed minimum amounts of money in a certain agreed number of years. If, unfortunately, after an agreed number of years, exploration does not result in a commercial discovery, the agreement automatically becomes null and void. The transnational will not be reimbursed in any way. If, on the other hand, exploration does result in commercial discovery the host country will have to reimburse the foreign partner for its share of the exploration expenses in accordance with a predetermined procedure.[239] The agreements contain such obligations because of the potential conflict between the host country and the transnational oil company which arises from the motivation of exploring for oil.[240] The purpose of these clauses is to make certain that the foreign oil company maximises input into exploration, not only to maximise the delay between the signing of the agreement

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[235] Lennart Ritter and Colin Overbury, 'An attempt at a practical approach to Joint Ventures under the EEC Rules on Competition' (1977) 14 Common Market Law Review 601, 623.
[236] Quoted from Herzfeld and Wilson (n 223) 30.
[237] Kenichi Ohmae, *Triad Power* (New York: The Free Press 1985).
[238] Paul J Stevens, *Joint Ventures in Middle East Oil* 1957-76 (The Middle East Economic Consultants 1976).
[239] *Ibid.*
[240] *Ibid.*

and the date of commercial discovery, but also to maximise the data produced for use by the host country.[241]

Furthermore, the signature bonus paid by the transnational oil company when the agreement is first signed has been common everywhere, notably in the Iranian agreements. It has two main purposes: chiefly, to increase the revenues and to speed up exploration activities. Which of the two is more important depends on whether the bonus is recoverable or not. In a situation where the bonus is non-recoverable, it provides no incentive to speed up exploration and can be regarded as a way of increasing revenue for the host country, but in the case where the bonus is recoverable from future earnings subsequently, most probably *ceteris paribus*, it clearly constitutes an incentive to the company to find commercial oil as soon as possible so that it can begin to recover its expense on the bonus.[242] In addition, the bonus also acts as an advance on revenue to the host country in the sense that the host country gets an interest free loan if a discovery is made, while if no commercial discovery is made the host country has at least gained some revenue in the form of the bonus. For instance, Iranian vintage agreements with Shell and the Tidewater Group, both of which failed to find commercial oil, paid to Iran $99 million, a sum equivalent to 55% of the consortium's payments to Iran in the same year.[243] Most times, the signature bonus is intended to be a sign of the prospects for the area; nevertheless, it has frequently proved an inaccurate measure.[244] Minimum work obligations in terms of financial expenditure and or the number of rigs to be operated or the metres to be drilled are prevalent in all the agreements. Such a bonus provides the most direct encouragement to the foreign company to maximise input and minimise lag. However, the only downside is a probable lack of flexibility if the obligations implicit are in technical rather than purely financial terms.[245] A commentator has remarked that if the foreign company can withdraw before the end of the contract period, then a minimum work obligation becomes meaningless. Some agreements, nevertheless, cover this by forcing the foreign company to fulfil certain

[241] *Ibid.*
[242] *Ibid.*
[243] *Ibid.*
[244] *Ibid.*
[245] *Ibid* 45.

obligations before opting out and to pay compensation if these obligations are not met.[246]

Normally, in a Joint Venture Agreement, the foreign company provides the financial resources and technical expertise.

In addition to marketing its own share of the oil, the Transnational Company also undertakes to market part of the entire share of the national entity, if the latter so wishes. The joint venture usually runs for a period of twenty-five to thirty years, renewable for a further period of about half of the original duration.[247] The effective date of the Joint Venture can either be the date of the beginning of commercial production, which tends to make the term of the agreement run separately for each field in which commercial oil has been found, or the date on which the agreement was signed, or the Law of authorisation published in the official gazette, which normally makes the duration the same for all fields, regardless of the date of commencement: Egypt is a classical case.[248] The agreement might also make some provision for the amendment of the original contract to incorporate the improved terms that the National Oil Company might subsequently obtain under similar Agreements with other partners.

A relinquishment program regulates the Joint Venture so that after a predetermined period of time the Joint Venture will be left only with areas where commercially exploitable deposits have been discovered. While this is expected to speed up exploration, a too rapid rate of relinquishment may well defeat its own end since the company may not have sufficient time to carry out the work properly. How far this is likely to happen depends on the size of the area to be covered and the uncertainty attached to the area. One would have thought the relinquished area may have an enhanced value for the host country since it is an area in which the level of uncertainty has been reduced and the area can be re-let, except for the fact that all the evidence is very discouraging.[249] In addition, the sharing of profit is usually a fifty-fifty formula which was already in operation under the concession regime when these joint venture agreements were first introduced. Such agreements have also provided for payment of rent and royalty. A good example is the one stipulated

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[246] F Parra, 'Oil Concessions and Contracts Dealing with Uncertainties' (1970) 14 Middle East Economic Survey.
[247] *Ibid.*
[248] *Ibid.*
[249] Stevens (n 238) 46.

under the renegotiated Getty Agreement of 1968 in Algeria, where Getty undertook to reinvest 75 per cent of the profits of the sale of oil.[250]

2.11 TYPES OF JOINT VENTURE

There are fundamentally two types of joint venture: equity joint venture and contractual joint venture.

2.11.1 Equity Joint Venture

Equity joint venture (under the Italian approach) is usually characterised by closer partnership ties. The joint venture is a separate entity in the form of a joint stock company created under the local laws of the host country to conduct, as a corporate body, all phases of the operations, as well as the marketing of oil.[251] These types of joint venture encompass arrangements where direct and significant participation in the investment is made by the two parties to the company.[252] Know-how, technical assistance or personnel are made available under the contract between the operating company and the foreign partner. The operating company is run as an independent corporation, with profits distributed to the parties to the joint venture in the form of dividends.[253] The parties exercise control of capital stock.[254] Key decisions, including policy are developed by the operating company. Autonomously, in theory, of the holding companies, in "the equity type of joint venture, the ratio of participation varies between a foreign minority, a foreign majority and a 50-50 arrangement".[255] In no case is the mutual control by the parties affected. When the local partner has a minority of interest, it may still enjoy a right of veto. It is typical that when the foreign partner is in the minority, the host party's lack of technical expertise and know-how may result in the foreign partner acquiring a greater degree of control.

Further it can be remarked that the earliest joint ventures were those established by ENI, an Egyptian consortium, Agip Meraria (an ENI subsidiary) and NIOC of Iran, in 1957.[256] In this case, each partner owned 50 per cent of the equity. The company

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[250] *Ibid.*
[251] Hasan S Zakaria, 'New directions in the search for and development of petroleum resources in the developing countries' (1976) 1 Vand. Journal of Transnational Law 545.
[252] Friedman and Kalmanoff (n 108) 6.
[253] *Ibid.*
[254] *Ibid.*
[255] *Ibid.*
[256] Muhamad A Mughraby, *Permanent Sovereignty over Oil Resources: A Study of*

was in charge of the functions of exploration and sale of any crude oil or other hydrocarbon that was produced. It has been argued that "the symbolism of the joint venture lies not simply in its jointness and in the existence of an entity called a State Oil Company, but also in the fact that the territory is not licensed solely to a foreign oil company."[257] Agip could retain only those areas in which commercial quantities of oil were discovered.[258] A commercial quantity embodied in the ENI-Agip agreement was as follows:

> *"The yield capacity of a petroleum field in commercial quantities in which a commercial quantity will, under prevailing conditions, be estimated when the amount of oil extraction reasonably foreseeable is such that when the cost price of delivery seaboard, calculated on the basis of production costs plus transport and handling charges and an additional 12.5% of the posted price payable as a minimum for tax and duties to the Iranian government is deducted for the posted prices of a similar kind of petroleum, it would leave a reasonable margin of profit."*

It is important to note that this agreement, however, did not incorporate a mechanism which would enable one party to proceed to development at sole risk, in the event that there was difference between the parties on the assessment of the commercial prospects of a discovery. Such a problem however arose under the Agip – NIOC agreement. To correct such anomalies, a formal mechanism was incorporated in the Agip – NIOC agreement to deal with the deadlock. This mechanism was not satisfactory, even though it provided a formal procedure for resolving a deadlock; it was more akin to an adjudicatory procedure than one for arriving at a consensus in the interests of the joint venture.

Furthermore, with time, a more resourceful mechanism was developed and incorporated in later joint venture agreements to deal with situations where the parties did not agree on the commercial prospects of a discovery. A clause was inserted which enabled either party to undertake discovery at its sole risk. For this reason, the risk clause was incorporated in the Pan American – UAR Agreement of

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Middle East Oil Concessions and Legal Change, (Beirut: The Middle East Research and Publishing Centre 1966) contains a detailed studies of early joint ventures see particularly part II, 45-116.

[257] Kenneth Dam, *Oil Resources: Who Gets What How?* (Chicago: University of Chicago 1976) 15.

[258] *Ibid.*

1963, under which the operations were assigned to the joint operating company, the Fayoum-Petroleum Company (Fapco).[259]

The sole risk clause was invoked in the Abu Qir gas discovery in Egypt by Phillip in 1969, which the company did not regard as commercial but which the government decided to develop at its "sole risk" in order to meet domestic requirements.[260] To some extent the sole risk clause may make the definition of a commercial discovery redundant.[261] The sole risk clause allows either partner to develop a field at its own risk subject to certain conditions and provisions. This clause allows either side to opt out of the development of the find.[262] Nevertheless, the sole risk clause usually only becomes operative once the venture has been created, i.e. a commercial discovery has been formally declared which still leaves open the problem of defining the first discovery as commercial or otherwise. What the sole risk provision actually does is to make the precision of the definition less important, given that once the venture exists, neither party is obliged to commit itself to the development of the field as the result of a declaration of commercial discovery. In addition, the "sole risk" clause has been praised as one of the commendable instances of elasticity made possible by the joint venture structure. The sole risk clause was introduced to provide a remedy for partnership problems where using arbitration clauses of the agreement was regarded by both sides as tantamount to a divorce.[263] In a situation where the sole risk operation has been wholly financed by the opposing party in case of a failure then the loss is borne by the opposing party only. But, on the other hand, if the sole risk operation is a success then after a certain time the opposing party has the right to join in the operation but must pay a penal rate to do so[264]. Moreover, another case of flexibility is provided by the mechanism, embodied in the Pan American-UAR Agreement of 1963, to deal with a situation where a project is approved by both parties, but one party is either unable or unwilling to share in financing it.[265]

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[259] Kamal Hossain, *Law and Policy in Petroleum Development: Changing Relations Between Transnationals and Governments'* (New York: Nicholas Publishing Company 1979). See generally, Ernest E Smith, John S Dzienkowski, Owen L Anderson, Gary B Conine and John S Lowe, *International Petroleum Transactions* (US: Rocky Mountain Mineral Law Foundation 1994) 351.
[260] Stevens (n 238) 48.
[261] *Ibid* 48.
[262] *Ibid* 49.
[263] Wali Alli, 'Perspective on the Egyptian Oil Industry MEE' XII 52, 3.
[264] Stevens (n 238) 53.
[265] *Ibid.*

In terms of the production phase, an obligation was imposed on the joint company to use all its possible efforts in order to raise to a maximum the sales level of production and for that purpose to develop the production of such fields so that production was achieved within the limits compatible with the most modern technical procedures in the oil industry.[266]

One conspicuous problem presented by the joint venture is the relationship between production and "offtake" by the respective parties. So long as both parties lift oil in proportion to their equity interest, the arrangement presents no difficulty. However, Stevens explains that a "problem arises when there is a persistent under-lift. The obvious solution would be for the over-lifter to provide the necessary additional capital, but this would create the problem of altering the equity share of the two sides. Consequently, the over lifter must be able to buy crude from the persistent under lifter at a specific price. Intended for both parties to invest in the necessary capacity in such a way as to leave the equity interest unchanged, the under-lifter must receive a price for the crude oil which will provide a return on capital equal to or greater than a return from any alternative form of investment. The joint venture therefore had to provide a mechanism to deal with a situation where one party is likely to persistently demand less crude in proportion to its equity than the other".[267]

Secondly, the price demanded by the under-lifter as compensation should not be so high as to have an effect on the level of demand of the offtake. This situation is convoluted by the fact that, in a joint venture state of affairs, the foreign company and the host country require the crude for different purposes. The transnational oil company has entered the venture to secure the supply of owned crude.[268] That is to say, the foreign company needs the crude as a refinery contribution. The host country's national company, on the other hand, will demand the crude as a revenue earner in a direct sense. The fundamental distinction is that the foreign company as an integrated operation is not unswervingly interested in maximising revenue at the production level of the operation, particularly with regards to one source of crude

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[266] See Article 12 of the Pan American-UAR Agreement of 1963. Quoted from Smith et al (1994) (n 208) 352.

[267] Stevens (n 238) 53; see also Hossain (n 259) 126. The period between early 1960 and late 1970 was a period of falling oil prices and the crude oil market was generally slack. During this period, it was the national oil companies of the host country who were sellers of crude oil and not to the processors as the latter had difficulties in disposing of their offtake. See for instance, the Iranian situation, where NIOC was anticipated as the under-lifter.

[268] Most transnational oil companies entering joint ventures to the present day have been crude deficit companies in the sense that their refinery capacities exceeded their supplies of owned crude.

from perhaps many accessible to the company. The host country nonetheless, is interested in maximising revenue at this stage as a seller of crude.[269] This problem is dealt with by different mechanisms embodied in the provisions relating to marketing under the Agip-NIOC agreement.

2.11.2 Contractual Joint Venture

A kind of joint venture broadly espoused is described as a contractual joint venture or a joint structure. The contractual joint venture is particularly common in joint ventures whose purpose is mineral exploitation. The device, even though infrequently dealt with as a distinct form of business organisation in the civil law or common law countries of the world, is nevertheless virtually always available under the general principles of contract law.[270] The contractual joint venture, which depends almost wholly upon the mutual agreement of the parties, is highly flexible.

The joint venture "does not assume a separate corporate identity, as the partnership is a not constituted into a joint stock company. Instead, an operating Company which is non-profit making in nature and registered under the Local Laws of the host country, is usually formulated to act as an agent for both the foreign and national oil companies. Its capital is contributed on an equal basis. The Company is mainly responsible for production and oil produced is handed over to each of the partners in equal shares".[271] The petroleum produced is not jointly owned; each party owns 50% of the undivided shares and consequently owns its share of production.

It is important to note here that although ownership of any petroleum discovered is joint and the operating company is jointly owned, the entire risk capital for exploration was to be furnished by the foreign partner.[272] In the event that no commercial discovery was made, the loss was exclusively borne by the foreign partner. In the event of a commercial discovery being made, the jointly-owned operating company would be remunerated out of the revenue earned.[273]

[269] Stevens (n 238) 50.
[270] Zakaria (n 251) 561.
[271] *Ibid.*
[272] *Ibid* 562.
[273] *Ibid* 562.

During the exploration period, a joint venture acts as an agent only of the foreign partners while in the development and production, it acts as an agent to both parties.[274]

Furthermore, a possible handicap of a non-profit-making company is that it may not have at its disposal any reserves and could face operational limits approved by the partners. In practice, however, the budget can be planned so as to leave enough margin of financial freedom to the management. Also, as an agent, it has powers to take any action obligatory in case of an emergency. According to Friedman and Beguin, "the legal structure established by the 1965 agreement is not expected to hamper efficiency of management although it is not denied that in certain exceptional circumstances it could be an obstacle".[275] Hossain further argues that "the provisions regarding joint structure agreements have been gradually strengthened over the years."[276]

In addition, the joint structure agreement provides for a signature bonus. The financial provisions in the joint venture agreements, while proceeding on the basis of equal sharing of profits between partners as under an equity joint venture, in effect yielded a more favourable result to the government. The signature bonus paid by the foreign company when the agreement is first signed, even though not used in Egypt, has been widespread, particularly in Iranian agreements. The provisions and operation of the signature bonus has been discussed in Section 2.10 above.[277]

Slight variations in contractual joint venture agreements are common. For instance, the agreement between NIOC/PAN-AM stipulates that if a partner is unable to provide the necessary funds, such a partner could resort to raising a loan or securing the necessary funds by any other method, provided that such method must have been agreed upon by the two partners.[278]

The date for commencement and defining the nature of activities is usually not uniform. After the commercial discovery of oil, the operating Company normally

[274] *Ibid* 562.
[275] Wolfgang G Friedman and Jean-Pierre Beguin, *Joint International Business Ventures in Developing Countries: Case Studies and Analyses of Recent Trends* (New York: Columbia University Press 1971) 48.
[276] Hossain (n 259) 129.
[277] In the Iranian vintage agreement of 1965, Shell and Tide Water and Group, both of which failed to find commercial oil, paid Iran $99 million, a sum equivalent to 55% of the consortium's payment to Iran in the same year.
[278] Zakaria (n 251) 561.

assumes the role of agent for both the National and Foreign companies. However, there are other Agreements, where the operating companies are to be established only upon commercial discovery of oil and within 30 days thereof.[279] This method or form of business cooperation has been preferred by the American oil companies because under the United States Tax Laws, American Companies investing abroad may obtain considerable fiscal advantages if they can prove to the tax authorities that they have direct ownership of their part of the production when such proofs are established.[280] Such American companies are entitled to deduct certain intangible expenses from the taxable account in the year of occurrence. In addition, the Company is also allowed depletion allowance,[281] which supposedly is a form of fiscal compensation for the depletion of deposits each year.

One can safely state that in a contractual joint venture arrangement, the national partner obtains exclusivity of title and ownership over installations and production and the foreign partner is limited to contractual rights for commercial compensation.[282] Maniruzzaman is of the view that the joint venture system of association is totally different from the traditional concession system.[283] When the fields discovered are being developed, "the host country takes a direct part in running the joint enterprise through its own managerial, administrative and technical staff, and this ensures that the country's interests are represented in all decisions affecting the formation of their oil revenue while at the same time the staff are acquiring training and experience".[284]

Equity participation in the local subsidiaries of transnational corporations does not substantially mean participation in the downstream operations of marketing, processing, procurement etc.[285]

It would appear that the law applicable to a contractual joint venture is generally for the parties to decide. In deciding their view, in particular, it is necessary to require the incorporation of a provision to settle disputes and to surrender to a *modus*

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[279] *Ibid* 561.
[280] *Ibid* 561-562; and Hossain (n 259) 128.
[281] Friedman and Beguin (n 275) 36.
[282] Zakaria (n 251) 562.
[283] A F Maniruzzaman, 'The New Generation of Energy and Natural Resource Development Agreements: Some Reflections' (1993) 11 Journal of Energy and Natural Resources Law 207-222.
[284] Charles Richard Dechert, *Ente Nazionale Idrocarburi: Profile of a State Corporation* (Leiden E J Brill 1963) 108.
[285] Asante (n 4) 336.

operandi for resolving them.[286] The non-existence of any preceding agreement on the applicable law can lead to adverse consequences, for instance when A and B, domiciled in two different countries, coalesce to perform a contract in country C, the laws of which may not be particularly appropriate to governing the relations between the parties and may even be hard to establish.[287] Most times the purchasing country maintains that its law is applicable to the supply contract. The fact is that the parties may have little choice but to agree to that arrangement, even though they may well wish their own internal relations to be managed as completely as possible by some other law with which they and their advisers are more familiar. The result would be that the joint venture arrangements would be governed, for instance, by Egyptian law but the supply law would be governed by the laws of the purchasing country. An additional choice is to acknowledge the local system of law, but to be in agreement to adjudicate in a third, unbiased country, e.g. Algeria.

The agreement for which a corporate body is formed settles the law applicable to that corporate body. The laws of some countries, such as France, do not recognise as valid agreements between shareholders about the conduct of a company.[288] In choosing where to locate a corporate entity, these questions of applicable law must play a significant role.[289] Where a corporate joint venture is being formed to carry out activities in a particular territory, the requirement for local credibility will frequently dictate that the joint venture is corporate under the laws of the country concerned. [290]

Furthermore, it would appear that while most legal systems allow contracting parties latitude in arranging their affairs, joint venture contracts belong to the group covered by the phrase "complex long-term contracts".[291] This, in some legal systems, particularly on the Continent of Europe, may mean that they are subject to renegotiation and probable judicial or arbitral modification in the event of an essentially changed state of affairs.[292]

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[286] Herzfeld and Wilson (n 223) 33.
[287] *Ibid.*
[288] Herzfeld and Wilson (n 223) 115
[289] These and related questions, such as the language governing an agreement, have been received from the point of view of a US participant.
[290] Herzfeld and Wilson (n 223) 34.
[291] *Ibid* 35.
[292] *Ibid* 35.

Also, in international joint ventures, it must be remarked that arbitration clauses can often be found in the joint venture contract.[293] This, coupled with the choice of a governing legal system which would be neither party's first choice but may perhaps be in the law of the country where the arbitration is meant to take place, and is occasionally considered an appropriate compromise. There is no doubt that a court or arbitrators might, in certain state of affairs, regard such a choice of law as invalid; and even more critically, it may, if upheld, lead to quite unexpected results unless the parties have totally satisfied themselves about the consequences of the legal system of their choice on any interpretation of their contract. In particular, in some jurisdictions, arbitrators have the right to adjust a contract to what they see as apposite in the situation.[294]

It has been recommended[295] that in international joint ventures relating to numerous parties there is a good case for multi-party arbitration. This would appear to have validity where all parties request a declaration of the same problem and has the additional advantage of reduction in time and costs. However, it must be borne in mind that notwithstanding any provision for multi-party international joint venture arbitration, scores of disagreements may possibly not be of such a nature as to be amenable to arbitration in that type of forum.

There is a growing recognition that the progression from a traditional concession regime to a joint venture does not significantly affect the location of control of the decision-making process, so long as a corporation continues to manage the undertaking. In short, the mere acquisition of a majority equity interest does not disentangle the extractive industries of developing countries from the global network of Western corporations or the occurrence of the old international economic order.[296] Unless transfer of ownership is matched by a meaningful transfer of essential managerial powers and the acquisition and mobilisation of technical expertise for the purposes of effective management, the control of this sector by a developing country will prove largely illusory.[297]

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[293] *Ibid* 35.
[294] Konrad Zweigert and Bernd von Hoffmann, 'Zur internationalen Joint Venture' in O Glossner and W Reimers (eds) *Festschrift für Martin Luther zum 70. Geburtstag 13. Juli 1976* 209 (1976).
[295] Gillis Wetter, 'A Multiparty Arbitration Scheme for International Joint Venture' (1987) Arbitration International. Page 2 refers to 'projects', in other words, contractual joint ventures.
[296] Asante (n 4) 352.
[297] *Ibid.*

2.12 JOINT VENTURE AND CONTROL OVER NATURAL RESOURCES BY HOST COUNTRIES

For some time now, most developing countries have sought to establish control over the activities of transnational corporations by obtaining a majority interest in the equity or assets of their local subsidiaries.[298] The general experience of most host governments is that the corporate structure of transnational corporations consistently denies the subsidiaries that measure of self-sufficiency that would permit them to be wholly incorporated into the economic strategies of the host country.[299] For that reason, the attainment of control over subsidiaries is regarded as a compelling device for dismantling the restrictions imposed by the parent company.

In following this device, some developing countries appear to have advanced on the premise that the acquisition of ownership necessarily implies effective control, but the experience of many developing countries, predominantly in Africa, belies this proposition. This was the reasoning of the court in the case of *Anaconda Company v Overseas Private Investment Corporation*[300] and the tribunal came to the conclusion that "control, as applied to corporate operations, is an elusive term dealing, as it sometimes does, with the degree of influence in fact or potentially exerted by some persons within a complex structure over a multitude of actions taken by many others. In differing legal contexts, different aspects of that influence can assume greater or lesser importance; sometimes actually exercised present control is more important than potential but dormant control and sometimes the reverse is true".[301]

2.12.1 Three phases in quest for control over natural resources

According to Asante, it has been observed with time, that developing countries with fragile independence structure experience three distinct phases in their quest for control over their natural resources.[302] Also, "each phase has a distinct political significance, though it may exert little or no impact on the existing structures for controlling the development and exploitation of the particular natural resource".[303]

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[298] *Ibid.*
[299] *Ibid.*
[300] *Anaconda Company v Overseas Private Investment Corporation* [1975] 14 ILM1210 P. [1227].
[301] *Ibid.*
[302] Asante (n 4) 352.
[303] *Ibid* 346.

2.12.1.1 Political sovereignty

The achievement of political sovereignty is the first phase. Nationalists inveighing against a colonial regime have always looked upon political independence as tantamount to economic independence and unregulated control over their natural resources.[304] However, after the initial excitement over this phase, developing countries soon came to realise that control over their natural resources was still a distant goal.[305]

2.12.1.2 Vesting Mineral Resources in the State

The next phase consists in the formalisation through legislation that all mineral resources are vested in the state.[306] It soon becomes apparent that actual control does not fundamentally begin from such formalisations. It would appear that effective control of the undertaking in economic or practical terms may still elude the host government even after taking this step, however politically appealing it may at first appear.

2.12.1.3 Control Within the Transnational Investment Process

Asante further provides that "in the transnational investment process, control involves the exercise of decision making powers in such vital operational and managerial matters as budget, expansion and development programs, appointment of top management, pricing, marketing, declaration of dividends, borrowing, reorganisation, procurement of equipment, and the integration of the undertaking with the developmental objectives of the host countries".[307] Thus, an appropriate test of the suitability of any new arrangement the proper test of the suitability of any new arrangement asserting to vest control in the host government will include consideration of the following factors:

(1) Does the acquisition of a majority equity position confer upon the host government the right to recommend a majority of the members of the governing board or committee? Some developing countries generally appoint only half of the members of the board or committee, notwithstanding their

[304] *Ibid* 346.
[305] *Ibid* 346.
[306] *Ibid* 347.
[307] *Ibid* 347.

majority equity position.[308] This type of arrangement vitiates any substantial control that government has at board level. In consequence, a concession to the suggestion much explored by transnational corporations that "a genuine joint venture means a 50:50 equity partnership in which neither party has a controlling interest is an explicit acknowledgement of the principle that majority ownership and control are two separate concepts".[309]

(2) Does the host government really wish to have control? A good example is Ghana, which terminated its management agreement with all foreign-owned timber companies in which it acquired a majority equity interest. Lipton succinctly summarised the financial repercussions of the joint venture as follows: "A Joint Venture Company is consistent with the national aspirations of developing countries, but their Governments recognise that taking shares in the company is not going to change the 'bottom line' figure to an investor. Whether a mining company pays a Government in the form of dividends, royalties, profits taxes, bonuses or surface rentals, such payments must come out of the 'bottom line'. The return to the investor is discounted cash flow."[310]

(3) Is the arrangement the status quo in *new clothing*? The international corporations themselves have overcome their reservations about joint ventures with host governments in the extractive sector. They have also realised that such ventures may effectively resolve nationalist objections to foreign control of natural resources without significantly thinning the corporation's actual control or its financial gains or returns.[311] Furthermore, from the operational viewpoint, The Government's equity interests coupled with the presence of important Government officials on the board of the Joint Venture assures easy access to local capital and other facilities such as import licenses and permits from the Government agencies and then, by so doing, improves communication between the host country and the foreign company.[312] Newly instituted indigenisation schemes, now very much in vogue in Nigeria, Ghana and many other developing countries, have, as their sole object to enable nationals to assume command of the economy. But it needs

[308] *Ibid* 347.
[309] *Ibid* 347.
[310] Lipton, 'Fiscal Aspects of Negotiating Third World Mineral Agreements' (1976) 59 Transactions of the Society of Mining Engineers 260, 261.
[311] Asante (n 4) 356.
[312] *Ibid.*

to be appreciated that the transfer of a majority equity interest in foreign owned enterprises to the citizens of the host country does not necessarily guarantee a change of control. Problems posed by ownership and control have attracted the attention of the intergovernmental working group of the United Nations Commission on Conduct for Transnational Corporations.[313]

2.13 THE TRAINING FUNCTION OF JOINT VENTURES

Despite the drawbacks of the joint venture agreement, it must be emphasised that firstly, joint can be employed as a valuable tool for management and technical training.[314]

Secondly, they engender access to the operational strategies, policies, and techniques of multinational corporations, and as such, can provide developing countries with useful insights into effective management considerations and techniques.[315]

The fact remains that there are drawbacks in such an arrangement, specifically the inability to achieve openness on the part of the transnational partners, and these may effectively undermine the development strategies of host governments; a government faced with such daunting tasks can rely on its sovereign rights to "impose an external regime of laws, regulations and administrative practices, which may subsequently achieve the control that has eluded its representatives in the boardroom".[316] Asante went further to explain that:

> *"The search for control and increased financial returns on the part of host governments, principally in the petroleum producing countries, has given rise to a range of contractual arrangements with transnational corporations which, in form at least, represent a substantial departure from the traditional regime. The common characteristic of these new forms of agreement is that they underscore the status of the host State as the undisputed owner of the natural resource to be developed. They are formally structured to dismantle the enclave status enjoyed by the Transnational Corporation in the traditional concession and to reassert*

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[313] *Ibid.*
[314] *Ibid* 357.
[315] *Ibid.*
[316] *Ibid.*

in unqualified terms the sovereignty of the host State over its natural resources"[317]

Unlike the traditional concessions, these new arrangements do vest title in the multinationals; rather, they give them the opportunity to perform certain specified tasks for a fee or consideration in kind.[318] Governments of host countries have stated in clear terms their desire to assert state ownership of natural resources and have enacted legislation expressly abolishing the outdated and outmoded systems as being very incompatible with statehood and their sovereignty.

2.14 JOINT VENTURE AND PARTNERSHIP DISTINGUISHED

Time and again, there have been decisions that emphasise the difference between joint ventures and partnerships. Jaeger outlines key factors from the examination of certain case law:

1. The single or *ad hoc* nature of the undertaking;
2. The eligibility of corporations for membership;
3. Absence or extreme limitation of agency relationship;
4. Lack of entity;
5. Loss-sharing not essential;
6. Action on the contact;
7. Status: *Delectus personarum*, unnecessary;
8. Death of member does not terminate joint venture.[319]

Various attempts have been made to distinguish between the joint venture and other types of association, in particular the partnership. In ascertaining the law relating to joint ventures, it is first necessary to determine whether the joint venture is a species of partnership. Some aspect of the law of partnership may extend to joint ventures but whether this is so, will largely depend on the extent to which it is appropriate to draw a comparison between the joint venture and a partnership. In England and a

[317] *Ibid* 359.
[318] *Ibid* 359.
[319] Jaeger (n 90) 2-5.

range of ex British colonies, Australia, for instance, "partnership" is defined[320] as the relation which subsists between persons carrying out a business in common with a view to profit.[321] Furthermore, the Income Tax Assessments Act[322] states that "partnership means an association of persons carrying out business as partners or in receipt of income jointly but does not include a company."[323] Professor Crommelin has remarked that:

> *"The definition employs a composite expression: persons carrying on a business in common with a view of profit. While it is usual to analyse that expression in terms of its principal elements (business, in common, view of profit) that approach appears artificial and could mislead. For example, concentration upon the elements of the definition might suggest that it is sufficient for the profit motive to be present in each person as regards his individual activities, whereas treating the definition as a composite expression requires the conclusion that the profit motive attaches to the persons as a group in the conduct of their common business."*[324]

It can be argued from the definition above that the mineral and petroleum joint venture is not a partnership, since each partner in the joint venture is undoubtedly engaged in the business of discovery and exploitation of natural resources with a view to profit. Although the participants are carrying out some common activities, they are not carrying on a business in common with a view to profits. Nonetheless, they are carrying on several businesses, each with a view to making profit, some aspects of which are performed in common.[325] As enshrined in the Partnership Act,[326]it can be adduced that, tenancy in common does not itself create a partnership as to the property so held and more significantly, the sharing of gross returns does not itself create a partnership.

In *United Dominions Corporation Ltd v Brian Pty. Ltd.*, Mason, Brennan and Deane JJ said:

[320] Partnership Act (n 119) Section 1.
[321] Partnership Act (n 119) Section 5(1).
[322] Income Tax Assessments Act (1936) (Cth).
[323] Partnership Act (n 119) Section 6(1).
[324] Crommelin (n 98) 77.
[325] Merralls (n 124).
[326] Partnership Act (n 119) Section 5(1).

> *"The term 'joint venture' is not a technical one with a settled common law meaning. As a matter of ordinary language, it connotes an association of persons for the purposes of a particular trading, commercial, mining or other financial undertaking or endeavour with a view to mutual profit, with each participant usually (but not necessarily) contributing money, property or skills. Such a joint venture (or under Scott's law, 'adventure') will often be a partnership. The term is, however, apposite to refer to a joint undertaking or activity carried out through a medium other than a partnership: such as a company, a trust, an agency or joint ownership. The borderline between what can properly be described as a 'joint venture' and what should more properly be seen as no more than a simple contractual relationship may on occasion be blurred. Thus, when one party contributes only money or other property, it may sometimes be difficult to determine whether a relationship is a joint venture in which both parties are entitled to a share of profits or a simple contract of loan or a lease under which the interest or rent payable to the party providing the money or property is determined by reference to the profits made by the other. One would need a more confined and precise notion of what constitutes a 'joint venture' than that which the term bears as a matter of ordinary language before it could be said by way of general proposition that the relationship between joint venturers is necessarily a fiduciary one: ... The most that can be said is that whether or not the relationship between joint venturers is fiduciary will depend upon the form which the particular joint venture takes and upon the content of the obligations which the parties to it have undertaken."*[327]

Similarly, Dawson J came to the conclusion that "perhaps in this country the important distinction between a partnership and a joint venture is, for practical purposes, the distinction between an association of persons who engage in a common undertaking for profit and an association of those who do so in order to generate a product to be shared amongst the participants. Enterprises of the latter kind are common enough in the exploration for and exploitation of mineral resources

[327] *United Dominions Corporation Ltd v Brian Pty. Ltd.* [1985] 59 ALJR 676.

and the feature that is most likely to distinguish them from partnership is the sharing of product rather than profit. It is, however, unnecessary to pursue that matter here."[328]

Consequently, the Joint Operating Agreement governs the core rights and duties of the participants inter se. Where a fiduciary obligation is to be imposed on a participant the obligation "must accommodate itself to the terms of the contract so that it is consistent with, and conforms to, them".[329] The courts will not superimpose upon a Joint Operating Agreement a fiduciary obligation upon a participant, which will alter the operation which the Joint Operating Agreement was intended to have.[330] If there is to be a fiduciary obligation, it must accommodate itself to the relationship between the Participants created by the Joint Operating Agreement.

This was the view that was canvassed in the earlier case of *Mount Isa Mines Ltd v Seltrust*[331], where the trial judge was of the view that "this is not a case where one can ignore what the parties have said. Clause 2.5 expressly provides that a partnership does not exist. This, by itself, may not be sufficient to exclude such a possibility, but if it can be seen from the terms of the arrangement as a whole that it is not a partnership, then effect will be given to the statement of the parties that it is not".[332]

Compare *Australian Mutual Provident Society v Allan*.[333] In this case, the issue for deliberation was whether the contract was one of service or one of agency. If it was the former, then the respondent falls within the definition of 'worker' in section 3(1) of the (South Australian) Long Service Leave Act 1967.[334] As such, the main indicium of partnership was missing.

The ultimate equitable interest in the whole of the assets referred to in *Canny Gabriel Castle Jackson Advertising Pty Ltd v Volume Sales (Finance) Pty Ltd*.[335] Here, "at the end of the day, each of the parties takes in kind the object of the venture, i.e. nickel concentrate, and there is no express restriction on the way in which each deal with

[328] *Ibid*; Crommelin (n 98) 68.
[329] Paul Finn, *Fiduciary Obligations* (AMPLA Yearbook, 1977) 3.
[330] Crommelin (n 98) 69.
[331] *Mount Isa Mines Ltd v Seltrust* [1994] 13(4) AMPLA Bulletin [172].
[332] *Ibid.*
[333] Merrals (n 124) 3.
[334] *Australian Mutual Provident Society v Allan* [1925] 18 ALR 385.
[335] *Canny Gabriel Castle Jackson Advertising Pty Ltd v Volume Sales (Finance) Pty Ltd.* [1978] 52 ALJR 407.

that product".[336] He continues, "I make these comments only to indicate that the agreement not only states that it is not a partnership, but its provisions indicate, in fact, that it is not and were it necessary to do so, it can be distinguished both in this and other aspects from Brian's case".[337]

It can be suggested that the normal joint operating agreement does not involve that each participant is entitled and bound to take in kind its share of the crude or gas which is produced either at the well head, or if conveyed ashore by pipeline, then at the terminal, and to sell its share for its own account. The fact is that this arrangement does not amount to a sharing of profits which the partnership act definition requires. It would appear that the participants share the expenses of production but, however, sell the products separately. Ladbury remarked that it is likely that the difference between the mining joint venture and partnership is that in the joint venture the profit or gain will be derived by the venturers individually and will not be derived for their common or joint benefit.[338] The mining joint venture is an expense-sharing and production-sharing agreement. Although each venturer may have the object of individual gain, there is no joint profit motive and there is no joint profit; thus, the parties might be carrying out their business or undertaking in common, but they are not carrying it out for joint profit.[339]

2.14.1 Liability to Third Parties

A partnership is the type of association to which the joint venture has been most frequently assimilated. This is particularly true with regards to the right of third parties. The question of liability to third parties of the participants and the operator in the mineral and petroleum joint venture may arise in relation to the actions of the operator and those of an individual participant.[340] With regards to the actions of the operator, the law of agency determines the liability of the participants and the operator.[341]

In general terms, "the participants are liable to third parties both in contract and in tort for the authorised actions of the operator, whether the authority of those actions

[336] *Ibid.*
[337] *Ibid.*
[338] R Ladbury, 'The Joint Development of Resource Projects in Australia' (1998) 7-8.
[339] *Ibid.*
[340] Crommelin (n 98) 77.
[341] *Ibid.*

is actual, implied, apparent or ostensible".[342] Also, "the operator is not liable to third parties in contract for such actions but is jointly and severally liable with the participants to third parties in tort in respect of them".[343]

The standard rule that the contract of an agent concluded with authority binds the principal rather than the agent to third parties is not without exceptions. In the first instance, the agent rather than the principal is liable if the agreement displays an objective intention on the part of the agent to contract as principal.[344] Secondly, "both the agent and the principal are liable where the circumstances of a contract demonstrate an intention on the part of the agent to assume personal liability in addition to that of its principal".[345] Thirdly, in situations where the agent is a party to a deed and executes the deed in its own name, "the agent rather than the principal is liable even though it is described in the deed as acting for or on behalf of a named principal".[346] Fourthly, "the agent rather than the principal is liable on a bill of exchange executed by the agent".[347]

There is a growing controversy among scholars with regards to the mineral and petroleum joint venture whether the liability of participants to third parties in respect of the actions of the operator is joint or several. The usual case is that such liability is joint. It has been remarked that, "the *prima facie* rule is that a contract made by two or more persons is joint. Thus, where two or more persons give authority to an agent, the presumption is that they are authorising him to act only in such matters as concern them jointly, e.g. their joint property, and not in matters concerning one or the other alone. But there may be indications to the contrary: and of course, contractual liability (if there is a contract) of the co-principal may be held to be joint and several, rather than joint in appropriate cases."[348]

Furthermore, "liability to a third party in contract or in tort for the actions of an individual participant in the mineral and petroleum joint venture does not extend to the other participant unless the relationship of principal and agent exists between the participants and themselves".[349] It is a settled principle of law that a classic joint

[342] *Ibid.*
[343] Halsbury (n 131) 491.
[344] William Bowstead, *On Agency* (14th edition, 1976) 366.
[345] F M B Reynolds, 'Personal Liability of an Agent' (1969) 85 LQR. 92.
[346] Bowstead (n 344) 366.
[347] Bills of Exchange Act [1909] s.31 (Cth); Quoted from Crommelin (n 98) 78.
[348] *Ibid.*
[349] *Ibid* 78-79.

venture agreement does not contain any provision to this effect and, as a result, one should not be implied from the situation or conduct of the participants as participants in the mineral and petroleum joint venture. Nevertheless, there is constantly the likelihood that the words or conduct may give rise to agency by estoppel[350] between the participants in the joint venture.

The interest of a participant in the mineral and petroleum joint venture is twofold: proprietary and contractual.[351] However, the proprietary interest is that of a tenant in common in the assets of the joint venture while the contractual interest comprises *choses in action* relating to the management of the undertaking.[352] It can be argued that the interest is distinguishable from that of a partner in a partnership property. This issue came for consideration in *Canny Gabriel Castle Jackson Pty Ltd v Volume Sales (Finance) Pty Ltd*.[353] The court came to the conclusion that "the partner's share in the partnership is not a title to specific property but a right to his proportion of the surplus after the realisation of the assets and the payment of debts and liabilities. However, it has always been accepted that a partner has an interest in every aspect of the partnership and this interest has been universally described as a beneficial interest notwithstanding its peculiar character…The interest of the partner in an asset of the partnership is *sui generis*…it is, as we have said, recognised as a beneficial interest. As such it constitutes an equitable interest and is not a mere equity to set aside or rectify a transaction by means of a court order …".[354]

2.14.2 Assignment

In a mineral and petroleum joint venture, are the rights of the participants assignable? It would appear that in a mineral and petroleum venture the capacity of the participant to assign its rights is dependent upon the nature of the interest. These interests could be proprietary or contractual and such aspects necessitate special consideration. In the case of proprietary rights, the capacity of the participant to assign those rights are clear, at least in the absence of a statutory restraint upon assignment.[355] However, the positions differ from one jurisdiction to another. In

[350] *Ibid* 79.
[351] *Ibid* 70.
[352] *Ibid* 70.
[353] *Canny Gabriel Castle Jackson Pty Ltd v Volume Sales (Finance) Pty Ltd* [1974] 131CLR 321, 327-328.
[354] *Ibid* 327-328.
[355] Quoted from Crommelin (n 98) 70.

Australia, for instance, where the position differs significantly from other places, it is established that a contractual moderation upon alienation of property is void as contrary to public policy.[356] There is no doubt that a contractual right of first refusal or right of pre-emption seems unlikely to be regarded as a moderation upon alienation, provided, at least, that the price payable upon exercise of the right does not depart too far from the value of the property rights to be assigned.[357] It has been argued that the complexities involved in a contractual right of first refusal or right of pre-emption concerns the extent of its enforcement. The common practice is that such a provision is not enforceable against an assignee of property, even where the assignee at the time of the assignment had notice of the restriction and was also aware that the assignment was in breach thereof.[358]

It is a settled principle of law that a court of equity will usually intervene prior to the completion of the assignment to enforce a contractual restriction against a party with notice thereof.[359] The usual remedy in such an instance is an injunction; the underlying principle for judicial intervention possibly lies in an inherent refusal of a court of equity to permit specific performance of the agreement to assign in breach of the contractual restriction. This was the view that was canvassed in the case of *De Mattos v Gibson.*[360] The dictum of Knight Bruce is remarkable when he noted as follows:

> *"Reason and justice seem to prescribe that, at least as a general rule, where a man, by gift or purchase, acquires property from another with the knowledge of another, with knowledge of a previous contract, lawfully and for valuable consideration made by him with a third person to use and employ the property for a particular purpose in a specified manner, the acquirer shall not to the material damage of the third party in opposition to the contract and inconsistently with it, use and employ the property in a manner not allowable to the giver or the seller. This rule, applicable alike in general as I conceive to moveable and immoveable property recognised and adopted, as I apprehended, by*

[356] *Hull v Busst* [1960] 104 CLR [206].
[357] Crommelin (n 98) 71.
[358] *Ibid.*
[359] *Ibid.*
[360] *De Mattos v Gibson* [*1858*] 4 De G & J [276].

the English law, may like other general rules, be liable to the exceptions from special circumstances…"[361]

It is doubtful whether the qualifications suggested in the case of *De Matos v Gibbons*[362] still hold water since they are contrary to the Doctrine of Privity of Contact. The underlying principle is that contractual restriction on assignment will not, by and large, be enforceable against an assignee of the property.

Conversely, a proprietary restriction upon assignment of the interest of the participants in the assets of a joint venture is not without its drawbacks. It has been argued that the rule against perpetuities undermines any such restriction pertaining to assignment, contingent, to a certain extent, upon the rights vested on assignment.[363] In addition, any such restriction may possibly be subject to statutory requirements of ministerial consent and registration with severe penalty attached to non-compliance.[364] There are also instances of extreme cases where an option to purchase may be construed as a restraint upon alienation especially if the price to be paid upon exercise of the option does not in any way disclose the value of the property to be assigned.[365] The question that readily comes to mind is to what extent can the contractual rights be assignable? It is not in doubt that the benefits of the contractual rights are assignable in equity.

Nonetheless, there exist some exceptions. For instance, where the contract calls for personal performance, the benefits in this case are unassignable except where the parties to the contract have indicated a contrary intention.[366] Further, the question then arises as to whether an assignment in breach of the restriction on assignment is enforceable. Once more, it appears obligatory to establish whether the joint venture calls for personal performance of the contract by the participants. Yet again, there is little doubt that an assignment of such contractual rights in breach of the restriction upon assignment is void. On the other hand, if the joint venture does not call for personal performance, the restriction upon assignment may amount to nothing more

[361] *Ibid* 282.
[362] (1858) 4 De G & J [276], [282].
[363] Crommelin (n 98) 72.
[364] *Ibid.*
[365] *Hull v Busst* (n 356).
[366] Crommelin (n 98) 72.

than a warranty, the breach of which may escalate to an action for damages, but which nevertheless does not nullify the assignment constituting the breach.[367]

2.15 FINANCIAL BENEFITS OF JOINT VENTURES

We now go on to question whether joint venture is mutually beneficial to the parties concerned and, in areas where there are lacunae, look at ways of dealing with such drawbacks. There is a growing recognition amongst commentators that financial benefits and costs of joint ventures may be consistently coordinated. From the host government's point of view, the financial and economic benefits depend to a large extent on the structure of the fiscal regime, the compensation formula for the equity interest acquired by the government, and the economic connection provided for in the arrangements.[368] The financial returns to the host government may be significantly increased if it retains the right to impose a royalty in addition to such other forms of return as taxes on the income of the venture and on the shareholders' dividends, surface rental, bonus payments, and mineral duty, not to mention the dividends which may accrue to its newly acquired equity.[369]

Furthermore, the joint venture agreement differs in a number of significant respects from the rentier arrangements. Initially, the host country obtains a direct share in the real profit of the operation as opposed to a merely fiscal benefit.[370] Whereas in the traditional concession the host country received 50% of the profit in tax, the profit was a notional accounting figure. In the early sixties, the income tax transformed into an almost pure per barrel tax, whereas in joint venture circumstances, the host country, through its national oil company, earns a proportion of the real profits of the operation.[371]

The financial benefits are less apparent where the governments obtain an equity interest in lieu of all royalties, income tax, and other obligation, as in the Lamco Project in Liberia.[372] Where such arrangements pertain, the amount of foreign capital and expertise brought in tends to be lower, and requirements for domestic capital

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[367] J G Starke QC, *Assignment of Choses in Action in Australia* (Sydney: Butterworths 1972) 64-66.
[368] Asante (n 4) 354.
[369] *Ibid.*
[370] M Adelman, *The World Petroleum Market* (Johns Hopkins University Press 1972) 210.
[371] *Ibid.*
[372] This is the effect of Section 9(9) and 8(a) of the mining concession agreement dated April 28, 1960, as amended, amongst the Liberian Government, the Liberian American-Swedish Mineral Co., and Bethlehem Steel. See Asante (n 4) 354.

and expertise are consequently higher in the case of a joint venture than in a completely foreign-owned subsidiary.[373] The joint venture approach consequently implies a lower aggregate level of investment for the company as a whole than would otherwise be possible. Furthermore, the fact that profits need to be "shared with the local equity holders creates a motivation for the parent company to reduce locally declared profits by making use of whatsoever flexibility exists in the pricing of inputs and outputs, by charging the full costs of technical, managerial, and other services supplied from headquarters or affiliates, and by other means".[374]

Lipton says that: "aside from the capital shortage, the primary pull towards joint venture appears to have come from the growing nationalism in the less developed countries. Enterprises in developing countries have tended to demonstrate a considerable reluctance to engage in joint venture. This reluctance has finally broken down as it has been revealed either that this is the only form of foreign investment available or that it at least contains advantages over wholly owned investments for relations within the less developed countries. A joint venture company is consistent with the national aspirations of developing countries, but their governments recognise that taking shares in a company is not going to change the "bottom line" figure to an investor. Whether a mining company pays a government in the form of dividends, royalties, profit taxes, bonuses, or surface rentals, such payments must come out of the "bottom line" – return to the investor, its inexpensive cash flow".[375]

Also, it is therefore not surprising that international corporations themselves have overcome their earlier reservations about joint ventures with host governments in the extractive sector. They have become conscious that such ventures may efficiently silence nationalists' objections to foreign control of natural resources without considerably reducing the corporation's *de facto* control or its financial returns.

It should be noted that quite independently from probable financial and economic benefits, joint ventures, when appropriately handled or supervised, could serve as functional mechanisms for management and technical training. They could also provide access to the operational strategies, policies and techniques of a

[373] Asante (n 4) 354.
[374] *Ibid* 355.
[375] C J Lipton, 'Fiscal Aspects of Negotiating Third World Mineral Agreements' (1976) 59 Transactions of the Society of Mining Engineers 260.

transnational corporation. To point out the possible drawbacks in such arrangements may effectively undermine the development strategies of host governments.

On the part of capital exporting countries, the range of motives expressed by transnational companies is wide. Friedman and Kalmanoff paint a very clear picture, which is as follows:

> *At one extreme, there is a strong opposition in principle to joint ventures; at the other there is an acceptance of joint venture as the most appropriate and rewarding way of doing business abroad. Between these two extremes, there are at least two intermediate positions: one prefers solo operations but accepts joint ventures as occasionally unavoidable; the other is neutral, accepting without any preferences either the joint venture or solo venture, depending on the dictates of opportunity, circumstance and direct advantage. The trend is toward increased acceptability of joint venture. It would appear that company policy, in earlier times unbendingly set in favour of solo ventures, has now yielded to a pliable policy of acceptance of joint venture.*[376]

2.16 CONCLUSION

In an effort to distribute risk, maximise the use of investment capital and divide the heavy costs of construction and operation, this study has identified that most developing countries seeking capital now resort to joint venture. The joint venture is beyond doubt one of the most flexible arrangements available. The idea may not be new, but in today's business climate there is a blend of mandatory economic and political forces that bring this form of operation into ever increasing use. A considerable amount of sovereignty is restored to the government's fiscal powers. The significance of such an extension of sovereignty is that once accepted by the company, it further reduces the areas where conflict can be expected.

Successful joint ventures are considered as fostering the achievement of the major goals by each partner. These goals are a clear stipulation and understanding of the objectives, interest and contributions of the joint venture partners and it is recognised that joint ventures are most likely to succeed when each partner has

[376] Friedman and Kalmanoff (n 108) 132-133.

clear cut objectives and its cognisant of the objectives and the interest of the other partner.

From the foregoing, the Nigerian version of joint venture, participation and joint operating agreement will form the crux of the next chapter. The essence of a joint venture is the successful acquisition of foreign technology leading to rapid technological assimilation and adaptation which is a *sine qua non* for industrial development, economic progress, and technological self-reliance.

Although the terms of joint venture agreements were initially more favourable to host countries compared with the traditional concession regime, they have not remained static. Due to the changed circumstances and the improved bargaining power of some of the host countries, particularly OPEC producer countries, many countries have been able to negotiate new and better terms of agreement. A joint venture expresses the idea of partnership, and it is only based on partnership that the economic progress of the less developed countries can be achieved and that it will be possible to impart the experience and resources of the more developed countries to nations that want to bridge the gap without sacrificing national pride and human dignity.

What measures did host nations take to regain control of their natural resources and judiciously share oil profits? What is the mischief and undoing of these contracts and why do the parties opt out of them? This is the focus of the next chapter.

CHAPTER 3

THE NIGERIAN VERSION OF THE JOINT VENTURE

3.1 THE EMERGENCE OF THE JOINT VENTURE TYPE AGREEMENT

The terms of the concession form of agreement did evolve to meet the changing situation in the fifties and sixties. However, as host countries became more interested in the question for control, even the modified concession agreement became less apposite to the new situation. The replacement of the old-style concession by the joint venture agreement as the dominant agreement for new acreage began in the late fifties. In the early sixties, apart from some Gulf States, no new agreements followed the concessions form of agreement. Stevens is of the view that although the existing concessions continued to dominate oil production, they too came under increasing pressure which culminated in the participation agreements of 1972.[377]

The joint venture arrangements will form the subject of this chapter. Their nature, purpose and terms, as applicable to the Nigerian oil sector, will be examined. Where appropriate, comparison will be made with other jurisdictions, with a view to establishing what such an arrangement should provide for.

The growth of this contractual form of arrangement was due to four major factors, mainly the obsolescence of the concession agreement for new acreage; the availability of new acreage; the liability of the host countries to pursue a course of sole development; and the rise of new oil companies. One significant factor that influenced the espousal of petroleum joint ventures in Africa was the success of the state-owned oil company, the Italian Ente Nationale Indro-carbon (ENI) and the National Iranian Oil Company (NIOC) led by its maverick, Enrico Mattei and operating through its subsidiaries.[378]

African and Middle East countries saw in the joint venture plan an opportunity to achieve a favourable balance between foreign exploitation and national economic sovereignty over natural resources. Such arrangements are necessary because two or more parties, for their mutual benefit, wish to share or apportion the high risks

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[377] Stevens (n 238) 7.
[378] *Ibid* 28-31.

and financial burdens associated with exploitation of petroleum products.[379] Also, other agreements are obligatory between such parties and the third parties that provide them with services which they are unable to provide for themselves.

Egypt was the first country in Africa to put a petroleum joint venture into practice. She championed the system of granting oil leases on much smaller acreages for shorter terms to many enterprises from many nations in contrast to the large acreages and long terms granted to a few oil companies in the Middle East under the traditional concession system.[380] During 1957, the Egyptian General Petroleum Corporation (EGPC), a state-owned agency and the Egyptian Co-operation Petroleum Company, a national company, entered into a joint venture contract with the International Egyptian Oil Company IEOC), a subsidiary of ENI, for exploration and exploitation of petroleum resources.

Other oil producing African countries followed suit namely Algeria, Libya, Tunisia, Ivory Coast and Gabon. ENI's prospecting licence in Nigeria gave an option to the Government to purchase 30% of the share capital of the Nigerian subsidiary of ENI (called the Nigerian Agip Oil Company) if commercial discovery was established.[381]

The new trend of petroleum joint venture amongst developing countries was given much impetus by the Organisation for Petroleum Exporting Countries which was founded in 1960,[382] with the tilting of the erstwhile contractual scale in favour of its member nations[383] as its primary objective. According to Etikerentse, during this period the United States corridors reverberated with the sounds of the demands by the developing countries for the reordering of the concepts of the old international economic order.[384] The basic truth is that in this period of time, the emergent developing countries began acting as prime movers, a change signalled by the United Nations resolution on permanent sovereignty over natural resources being passed by that body's General Assembly.

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[379] *Ibid*.

[380] M Olisa, *Nigeria Petroleum Law and Practice* (1997) 62.

[381] Annual report 1964-65, Petroleum Division of the Federal Ministry of Mines and Power Lagos, Nigeria. P 7 states that the option was for the acquisition of one third of the company's venture; however, the agreement by which the option was granted specifically gives to the government the option to acquire 30% of the share capital of the Nigeria Agip company. For detailed account see Olisa *ibid* 63.

[382] However, the groundwork for its formation had been laid down since about 1949. Nigeria joined OPEC in 1971.

[383] Although the groundwork for its establishment has been in the pipeline since 1949. Nigeria, however, joined OPEC in 1971.

[384] Godfrey Etikerentse, *Nigerian Petroleum Law* (2nd edition, Lagos: Drewdew Publishers 2004) 18.

The Organisation of Petroleum Exporting Countries (OPEC) Resolution XVI Article 90 of 1968 called for modification in the structure of the relationship between OPEC member states and IOCs.[385] It provided that[386] "where provision for government participation in the ownership of a concession holding company under any of the present petroleum contracts has not been made, the government may acquire a reasonable participation on the grounds of changing circumstances".[387] Plausibly, one of the reasons for the institution of the participation arrangement was a perceived need for Nigeria to become robustly involved in the exploitation of its petroleum. The potential for such arrangement to result in the acquisition by Nigerians of the skills and expertise required for petroleum exploitation must have been perceived. It must also have been seen that the participation arrangement is capable of leading to substantial increases in the revenue accruing to the Government of the Federation from the exploitation of its petroleum.

Another possible incentive for the institution of the participation arrangement is the urging from the OPEC on its members to either exploit its hydrocarbon resources directly or become participants in the exploitation. This was reiterated in a declaratory statement on petroleum policy in 1968; in which OPEC urge inter alia that:

> *Member countries shall endeavour, as far as feasible, to explore for and develop their hydrocarbon resources directly. The capital, specialists and the provision of marketing outlets required for such direct development may be complemented when necessary from alternate sources on a commercial basis. However, when a member Government is not capable of developing its hydrocarbon resources directly, it may enter into contracts of various types, to be defined in its legislation but subject to the present principles, with outside operators for a reasonable remuneration, taking into account the degree of risk involved. Under such arrangements, the government shall seek to retain the greatest*

[385] Kola Adeniji, 'State Participation in the Nigerian Petroleum Industry' (1977) IIJWTL 156. See also H S Zakariya, 'Sovereignty, State Participation and the Need to Restructure the Existing Petroleum Concessions' (1971) 10 Alberta Law Review 201, 223.
[386] OPEC Official Resolutions Press Releases. Although Nigeria had not joined at this time, the Act embodied the principle contained in the resolution. The resolution reaffirmed "the inalienable right of all countries to exercise permanent sovereignty over their natural resources in the interest of their national development as a universally recognized principle of public law".
[387] This resolution was affirmed in 1971. See Resolution 135 of July 1971 in OPEC Official Resolutions and Press Releases.

> *measure possible of participation and control over concessions. Where provision for participation in the ownership of the concession holding company under any of the petroleum contracts has not been made, government may acquire a reasonable participation on the ground of the principle of changing circumstances.*[388]

Another reason that can be readily adduced for the participation agreements' attractiveness and use amongst host countries is that they are seen as a medium to attract outside assistance in the form of large risk capital, technological and management expertise, which are necessary for the development of petroleum resources.[389]

It is further observed that the Resolution called on each member country to attain public sector participation in the oil industry operating within its territory and prescribed a guideline for the level of participation. The level of participation was a minimum of 25% participation by 1973 and of 51% by 1982.[390] Each and every one of the member countries has surpassed the minimum percentage and a number of them have, in addition to this, a total nationalisation whilst at the same time working out an equally satisfactory arrangement for foreign oil companies to carry on petroleum arrangements.[391] As a result, in most of the major oil producing countries these days, despite the fact that ownership of the hydrocarbon is vested in the state, the state is also an operator as well as the regulating and administrative authority governing its relationship with the transnational companies. In most of the cases, the state-owned oil companies in these countries operate as the instrument for achieving effective participation.[392]

There is a general view that where the special terms and conditions impose participation by the Government of the Federation, it becomes very important to

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[388] OPEC Bulletin No. 8, (1968), p. 4. Developments in the sixties were to alter the relative bargaining positions of the international oil companies and the producing countries. This could have led to the injection of participation by imposition as in paragraph 34(a) of the Schedule to the Petroleum Act as amended.

[389] Zakariya (n 385) 555.

[390] This new concept of host country rights has, of course, since been further re-emphasised in later Resolutions of the United Nations, such as those relating to the Declaration on the Establishment of a New International Economic Order and the Charter of Economic Rights and Duties of States. In addition, see Doc. A/RES/3281 (XXIX) 1974. See also Asante (n 4) 336-340.

[391] Olisa (n 380) 63.

[392] Maxwell Gidado, *Petroleum Development Contracts with Multinational Oil Companies, The Nigerian Experience*. (Maiduguri: Ed-Linform Services 1999) 136.

negotiate the terms of the participation agreement.[393] The negotiations, as prescribed by statute, take place between the Minister or his delegate(s) and the applicant for the license or lease.[394] The terms arrived at in the course of the negotiations are reduced into an agreement known as the Participation Agreement.

It can be suggested that a participation agreement is an assignment of a fractional interest in a petroleum leasehold estate together with the assets and funds employed in the development of the leasehold.[395] It is an example of agreements that create the common law relationship of co-ownership, co-tenancy or concurrent ownership. In the participation agreement, the company assigns and transfers to the NNPC an undivided 60% (80% in the case of Shell) interest in the subject matter of the assignment for a specified consideration. More often than not, the consideration was payable in oil at the option of NNPC. The underlying principle is that "the basis of determining the amount of the consideration is the fiscal net book value of the assets of the company as declared in the tax returns of the company preceding the effective date of the participation agreement".[396]

3.2 PARTICIPATION

3.2.1 Definition of Participation

Participation is a process whereby the host country gains an amount of equity within the operating company in the existing oil concessions.[397] The concept stems from a desire by oil-producing countries to acquire a greater share of the profits from producing and exporting operations within their borders and to exercise a greater control over such operations.[398]

As prescribed in paragraph 34(a) of the Petroleum Act 1969, provision is made permitting the Nigerian Government to participate in all licenses or leases granted since 1969 to explore and develop oil with the applicant for such license or lease.

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[393] *Ibid.*
[394] *Ibid.*
[395] Olisa (n 380) 71.
[396] *Ibid;* Book value is defined in the participation agreement between the Nigeria National Petroleum Corporation and each of the oil producing companies in Nigeria as the sum of all qualified capital expenditure (including construction in progress) as defined in the Nigerian Petroleum Profit Tax Act and all exploration, costs, intangible drilling costs, and similar and related expenditure less the cumulative capital allowable deduction based on such costs, and which were utilized by the company to reduce the company's Nigerian tax liability up to the effective date.
[397] D N Smith (1973) 67 AJIL Proc. 230.
[398] M A Ajomo, 'An Appraisal of the OPEC' (1977) 13 Texas International Law Journal 66.

The Act authorises the Federal government to attain participation in the oil industry by dialogue, to a certain extent, rather than through independent action. The Act prescribes that:

> *If he (the Minister) considers it to be in the public interest, he may impose on a licence or lease to which this Schedule applies special terms and conditions not inconsistent with this Act, including terms and conditions as to:*
>
> *a) Participation by the Federal Military Government in the venture to which the license or lease relates, on terms to be negotiated between the Minister and the applicant for the licence or lease…*[399]

All licences or leases are granted subject to the Petroleum Act, as revised, and the regulations made under it. They are approved subject to the unique terms and conditions in the Annex attached to it, if any.[400] The forms of an Oil Prospecting Licence and of an Oil Mining Lease as stipulated in the Schedule to the Drilling and Production Regulations specify these conditions. Where participation is obligatory, the annexure, it is suggested, can only be such as replicates the entailment of participation as special terms and conditions. To satisfy this, the annexure to the licence or lease has to consist of a statement imposing the special terms and conditions, the Participation Agreement and the Joint Operating Agreement (JOA) made under the Participation Agreement as enshrined in the Petroleum Act of 1969. [401]

In compliance with OPEC time table which expects members to acquire a participating interest in the operation of oil companies in their individual countries. Subsequent to Nigeria joining OPEC in 1971, specifically in April 1973, the Nigerian government obtained a 35 per cent equity share of all the licenses and this was to oscillate in stages to 60 per cent by July 1979. It signed JOAs with a variety of oil companies, controlled all the way through by a government-owned company, the Nigerian National Petroleum Corporation (NNPC).

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[399] Schedule 1 Paragraph 34 (a) of the Petroleum Act 1969.
[400] *Ibid.*
[401] *Ibid.*

During August 1979, the government nationalised the British Petroleum (BP) shareholding in the Shell operation, consequently leaving the Shell/NNPC upstream joint venture, remarkably, with a 20:80 equity split. By mid-1989, the ratio became NNPC/Shell/Elf/Agip 60:30:5:5 and by 1991, it became 55:30:10:5. Shell Petroleum Development Company of Nigeria Limited (SPDC), which today has more than 90 producing oil fields in the Niger Delta, is the operator of this joint venture. Its recent production accounts for more than half of Nigeria's total export.

The other matter is that the ratio of participation at the early stages was rather flexible;[402] it is usually as a result of the outcome of the negotiation with each oil company and whether or not the company involved was a holder of an existing Oil Prospecting License (OPL) or Oil Mining Lease (OML). As time went on, with effect from April 1973, Government participation at a level of 35 per cent was applied to other oil-producing companies in the country, that is: Gulf, Mobil, Agip-Phillips, Texaco and Pan Ocean.[403] An additional 20 per cent interest was acquired with effect from April 1974, giving a total government participation of 55 per cent.[404] This was followed by another acquisition of 5 per cent interest with effect from July 1979, and as such, from that date, the NNPC, as a transferee on behalf of the Government, owns a participating interest of 60 per cent in the operations and assets of all oil-producing companies in Nigeria, except those companies that are parties with NNPC to service contracts or production-sharing contracts.[405] The procurement of this interest made possible concrete government participation in the operations of oil companies in Nigeria. As a result of obtaining such participating interest, Nigeria's strategic position in a joint venture involves making payments in proportion to the costs of carrying out the oil operations of each company, and as a result collects its share in kind, that is to say in crude oil.[406]

[402] Gidado (n 392) 137.
[403] Uduiomo Itsueli, 'Privatisation legislation and contracts in the petroleum sector' (1993) 11(2) Journal of Energy and Natural Resources Law 94.
[404] Gidado (n 392) 137.
[405] All participation interest acquired by government became vested in the NNPC with effect from April 17, 1977.
[406] Gidado (n 392) 137.

3.2.2 Reasons for Government Participation

Government's greater involvement and participation in the operation of transnational petroleum companies located within the developing countries, with time became increasingly unavoidable for the following reasons.

The foremost reason given for government participation in the oil industry was that oil was going to play a strategic role in the nation's economy.[407] It would appear that in the case of Nigeria, government participation could be seen as a political as well as an economic necessity.[408] Other than in the case of Elf, participation was achieved through negotiation with transnational oil companies. [409]

Secondly, such controls permit the delivery of consistent rules for oil resource development. The design of a petroleum guiding principle must be better prioritised by public officials, given its importance to the economic growth of the country.

Thirdly, foreign exchange being a federal subject under the Constitution, the Federal Government is the only authority that can effectively pursue, in partnership with the oil companies, a policy that will not unfavourably affect the foreign exchange situation.[410]

Fourthly, because of the strategic significance of oil as one of the most important industries of the twenty-first century and its weight on many facets of national life and all areas of economic development, it is only natural that it should be jealously guarded in the interest of the nation as a whole.[411]

Fifthly, original deposits of petroleum are part of the national heritage and, with regards to those occurring beneath the continental shelf, the coastal State have the benefit of sovereign rights over them for purpose of exploration and exploitation, in

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[407] Adeniji (n 385) 160.
[408] *Ibid* 161.
[409] *Ibid.*
[410] Keith W Blinn, *International Petroleum Exploration and Exploitation and Exploration Agreements: Legal, Economic and Policy Aspects* (Euromoney Publications, 1986) 169. In the absence of contractual provisions pertaining to foreign exchange transactions, the multinationals may derive a certain measure of comfort from the fact that the general legislation governing current payments and currency-practices may not be depart from the principles stated in Article VIII of the International Monetary Fund. Articles of Agreement (Avoidance of Restriction on Current Payments and Avoidance of Discriminatory Currency Practices)
[411] Augustine A Ikein, *The Impact of Oil on a developing country: The case of Nigeria* (Westport, CT: Praeger Publishers 1990) 14. Bargaining strength continues to be controlled by the demand and supply of oil and the degree essentially of oil in the world market.

accordance to the 1958 Geneva Convention on the Continental Shelf.[412] For that reason, the State should have the sole discretion and power as to their disposition and the mode in which they are explored and exploited.

Furthermore, considering such intrinsic features of the petroleum venture with the colossal capital expense required, the high level of technical competence that is obligatory, and the huge risks involved, only the Federal Government has the capacity to put up with those burdens.[413] Besides, from experience all over the developing countries, only a strong government can impose enough sanctions to compel a foreign oil company to share the essential know how with an adequately large number of Nigerians to make a useful impact.[414] Even then, the outlook is at times doubtful and recourse is made to the support of friendly governments which either share Nigerian political or economic aspirations or have suffered and overcome the same pattern of exploitation.

In addition, private ownership and control of oil resources would deliver vast benefits to the few individuals that claim to own them. Rawls however highlights that these vast private benefits cannot guarantee a delivery of positive benefits to the rest of the nation. Furthermore, there is no guarantee that it will ease the "class struggle", particularly in nations which are characterised by largely fratricidal tribal societies.[415]

Lastly, federal control of oil resources is symbolic, in that it emphasises national heritage and the unity of a nation. It also serves to demonstrate that these resources should be developed for the benefit of all its citizens.

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[412] It replaced section 61(a) of the Mineral Ordinance 1914.

[413] Ikein (n 411) 14.

[414] *Ibid.*

[415] John Rawls, *A Theory of Justice* (Harvard University Press 1971). Rawls states: 'Each person [or community] possess an invariability founded on justice that even the welfare of society as a whole, cannot override. For this reason justice denies that the loss of freedom for some is made right by a greater good shared by others. It does not allows that the sacrifices imposed on a few mineral producing areas are outweighed by the large sums of advantages enjoyed by many [nationally and internationally] Therefore, in a just society, the liberties of equal citizenship are taken as settled: the rights secured by justice are not subject to political bargaining or to the calculus of social interest… the [t]ruth and justice are uncompromising'.

In addition, to play a role in the policy decisions of the company and to exercise de facto control over the oil industry,[416] participation by NNPC in the operations and assets of each oil-producing company has been in the following subject areas:

(a) The OPLs and OMLs held by the oil company,

(b) The fixed and movable assets of the company in Nigeria, together with development, production, transportation, distribution and export operations and related assets, such as offices, housing and welfare facilities, and

(c) The working capital appropriate to the joint operations of the OPLs and OMLs.[417]

It is significant to stress that the NNPC does not own shares or stock in any of the foreign oil companies with which it has joint venture operation agreements. In other words, NNPC only has a non-equity participation agreement with these companies.

In terms of acquisition of participation interests, consultations between both parties were cumbersome. In several instances, the consultation period with the NNPC would last as long as two years.[418] Also, reimbursement to the companies for the government's acquired interests was at first established on premise of the rationalised value of their assets.[419] In other words, this was based on a customary commercial calculation, wherein the value of the assets in future are calculated, regardless of the devaluation and qualifying capital allowances they had hitherto claimed on such assets.[420] With time, this formula was abandoned for an assurance of oil and buy back system.

3.3 CONSTITUENT PARTS OF A JOINT VENTURE AGREEMENT

In the case of a Nigerian petroleum joint venture, two or more oil companies enter into an agreement for joint development of oil prospecting licenses or oil mining leases (OMLs) and facilities.[421] Each partner in the joint venture contributes to the

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[416] P McPherson, 'Recent Developments in Petroleum Laws and Contracts' (1984) 33 *International Energy Law* 53 and M A Ajomo, 'The 1969 Petroleum Decree: Consolidating Legislation in Nigeria's Oil Industry' 66.

[417] See Article 1 of the Participation Agreement between the NNPC and ELF Nigeria Ltd 1985, the NNPC and Gulf Oil Company Ltd 1984, the NNPC and Shell Petroleum Development Company of Nigeria Ltd 1984, and the NNPC and the rest of the oil companies operating in Nigeria.

[418] Gidado (n 392) 139.

[419] *Ibid.*

[420] *Ibid.*

[421] *Ibid.*

costs and shares the benefits or losses of the operations, based on its proportionate equity interest in the venture.[422]

Similarly, under the joint venture arrangements, the relationship is defined not only by the License or the Lease but also by other agreements, e.g., a participation agreement; and a Joint Operating Agreement (JOA); The joint venture is also synchronised by a third agreement, the Memorandum of Understanding (MOU). Every joint venture (JV) functions under a JOA with the NNPC and an MOU with the Federal Government.

3.4 PARTICIPATION AGREEMENT IN NIGERIA

It is a basic fact that participation agreements in Nigeria are heterogeneous in structure.[423] There are two separate, but related agreements needed to achieve public participation in the oil sector: The equity share participation agreement and non-equity share participation agreement. In practice, the two agreements tend to become fused into one agreement, as is done in farm-out agreements between two private sector oil companies. By contrast, joint agreements in Kuwait, Qatar and Libya before total nationalisation, took the form of one single agreement covering participation, ownership, and the conduct and benefit of the joint venture operations.[424]

3.4.1. Equity Share Participation Agreements

Under this kind of arrangement, the government is a shareholder in the joint venture company and is allowed dividends to the amount of its equity share interest in that company. This arrangement requires the creation of a separate legal entity in the form of a joint stock company by a foreign oil company and the Nigerian Government or its agency. The company that is created is usually totally neutral vis-à-vis its parents and, as a result, can strive to unify its management approach and optimise human and material resources without recourse to the joint venture partners. In terms of representation on the Board of Management, this is solely dependent on the participation interest of the parties.[425] Management is by and large autonomous, and

[422] *Ibid.*
[423] Adenji (n 385) 163.
[424] Selected documents –the international petroleum industry 19 OPEC Vienna (1973) p. 97, 125, 126 and 146.
[425] Gidado (n 392) 140.

not subject to deviation or sway by the partners, who interfere only to protect their several interests if threatened at Board level.[426] The joint company usually has its own wholly discrete picture and perspective.

Prior to 1984, there existed only draft participation agreements, but over time, formal agreements came to be signed, in general between the NNPC and all the major oil companies in Nigeria in whose working interests and operations the NNPC had acquired varying levels or percentages of ownership.[427] Two reasons can readily be adduced for the delay in completing the Agreements. The first of these was the obstinate position taken by the oil companies regarding the value of their existing assets which NNPC wanted to acquire and the ensuing claims and counter-claims which justifiably persisted for long periods due to the major financial consequences involved.[428] The second cause of delay was the fact that there were regular and long interruptions because the Federal Government were unable to sustain the cadence of negotiations owing to the regular personnel turnover in its negotiation team.[429]

It has been commented that the 1984 official Participation Agreements replicate entire tranches acquired by the Government through NNPC (including the additional 5% taken from scores of the oil companies in July 1979); in the operation of the multinational oil companies in Nigeria. Similarly, were the Heads of Agreement (HOA) on off-take/scheduling and lifting signed alongside the Participation Agreements.[430]

3.4.2. Matters Dealt with in Participation Agreements

The chief matters dealt with in every Participation Agreement included the following:

(i) The proportion of each party's participation interests in the oil mining leases (initially owned 100% by the oil company listed in the Agreement's Annex I)

[426] Asante (n 4) 349. The government, through its majority representation on the board of the subsidiaries of the multinational companies can however, influence investment and production polices but day-to-day decision making is left to the companies.
[427] Adedolapo Akinrele, 'The Nigerian National Petroleum Company at a Cross-Roads: An Analysis of the Challenges of Funding, Commercialisation and Autonomy' (2003) 2(1) OGEL 3.
[428] *Ibid* 4; These acquisitions which were punctuated by protracted delays due to bitter disagreements by the oil companies over the valuation of interests and other bureaucratic factors meant that former participation agreements were not executed until 1984. Such delays in securing participation agreements also accounted for the protracted non-existence of joint operating agreements long after NNPC acquisition had been completed. This gave rise to the anomalous situation where from the time of acquisition through to the signing of the JOA in 1991, operation of joint venture business was conducted on the basis of the gentle man agreement.
[429] *Ibid* 4.
[430] Adedolapo Akinrele, 'The Nigerian Oil and Gas Law' (2005) OGEL 140.

and in the assets i.e. pipelines, flow stations, oil terminals, movable and immovable property. These interests in the assets are described as "undivided"[431]

(ii) The amount of consideration (fiscal) paid by the Government to the oil company in respect of the interest obtained.[432]

(iii) The prerequisite for a Joint Operating Agreement (with an Accounting Procedure) meant to be signed by the parties as soon as feasible after the implementation of the Participation Agreement, to obviously establish the parties' rights and obligations as to the method in which the joint venture is to function and be administered.[433]

One legal argument of interest in the ownership structure of the joint venture property is worthy of note. The matter has to do with the legal significance of the parties' interest being "undivided", a term not defined in the participation Agreement. There is a growing controversy amongst commentators such as Akinrele, as to the term as ordinarily understood, means that one party's interest or ownership in a particular joint property, though ascertainable, nevertheless is not discrete from the other party's interest in the same property.[434] One could indeed wonder what, subsequently, would be a court's decision in a situation where the tenement rate in a joint property is opposed by a joint venture company based on section 16(1) of the NNPC Act which exempts such NNPC's property from tenement rate payment. Thus, the non-NNPC joint venture partner needs to benefit by seeking to enlarge the protection enjoyed by an NNPC qualifying hereditament because the interests of the parties in such hereditament are undivided; e.g. pipelines or warehouse which cannot be actually taken separately for valuation purposes. This issue has been canvassed by the courts, amongst others, for instance the matter of Resolution in tenements rates payment, litigation filed by some local governments against some joint venture oil companies. The question pending for determination in these cases, is whether in light of the provisions of section 44(3) of the 1999 Constitution (same as section 40(3) of the 1979 Constitution and item 39 on the Exclusive Legislative List in the 1999 Constitution, a local government can impose tenement rates on hereditaments which are directly connected with "mines and minerals including oil

[431] See article 1 a) of the NNPC/Chevron Agreement.
[432] See Article d) of the NNPC/Chevron Agreement
[433] See Article 3.03 of the NNPC/Chevron Agreement.
[434] Akinrele (n 430).

fields, oil mining… and natural gas" e.g., pipelines, flow stations, storage tanks in a farm terminal, etc. These matters are still pending, begging for answers).[435]

A related question arises in respect of participation in oil services companies because, by virtue of the Nigeria Enterprise Promotion Decree 1977 (the NEP Decree), the NNPC acquired substantial equity shares in certain of these companies.[436] For example, the NNPC acquired an equity share ownership of 60% in the National Oil and Chemical Marketing Company (initially owned for 60% by B.P. Company Limited and for 40% by Shell) and the African Petroleum Company (initially owned for 60% by B.P. and for 40% by the NNPC). However, the nationalisation of B.P. was sparked off as a result of the fact that it shipped oil to South Africa, (which was against Nigerian government policy) and as a result of this ugly incident, Nigeria acquired the 60% interests that were owned by B.P. in both of these companies.[437] Following this event, it became apparent that the oil companies engaged in exploration and production operations were not in any way mentioned in the NEP decree in relation to the equity holdings. The Decree, in schedule 3, makes it expressly clear without any form of ambiguity that "all other enterprises not included in schedules 1 and 2, not being public sector enterprises, are exempted from the provisions of the act." This means that the government, acting through its agent the NNPC, has no equity share, but merely an equity participation agreement with the oil exploration and production companies.

Also, the NEP Decree, also known as the indigenisation Decree was enacted for the purpose of transferring proprietary interest in business organisation from foreign control to Nigerians. The Decree specifically categorises all business enterprises in the private sector into three groups, each carrying a different percentage of obligatory Nigerian participation, that is to say 100, 60, and 40 per cent in that order.

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[435] Section 44(3) of the 1999 Constitution states: 'Notwithstanding the foregoing provisions of this section, the entire property in and control of all minerals, mineral oils and natural gas in under or upon any land in Nigeria or in, under or upon the territorial waters and the Exclusive Economic Zone of Nigeria shall vest in the Government of the Federation and shall be managed in such manner as may be prescribed by the National Assembly'; Capitalising further on the above provisions, Item 39(1) Second Schedule to the 1999 Constitution has also vested in the National Assembly the exclusive powers to legislate on inter alia mines and minerals including oil fields, oil mining and geological surveys. The meaning of this is that irrespective of how aggrieved the oil producing communities of the Niger Delta may feel, over the natural resources ownership laws, no state or local government can give redress and solace. If true social and economic justice that will bring down the temple of militancy is to be achieved in the Niger Delta region, section 44(3) must be expunged from the constitution.

[436] Gidado (n 392) 140.

[437] Acquisition of Assets (British Petroleum Limited) Act (1979) 20 Laws of the Federation of Nigeria.

Similarly, the joint equity participation agreement between the NNPC and Shell/Agip/Elf, for purposes of gas liquefaction, led to the creation of a company known as Nigerian Liquefied Natural Gas Limited. Consequently, shares in this company were NNPC 60%, Shell 20%, and Agip 10% respectively. The NNPC similarly had substantial equity holdings in other companies such as Hyson and Bermuda Ltd.

It would appear that a similar mode of operations exists in both equity participation agreements and non-equity participation agreements. In fact, apart from the fact that it has a say in the management through its Board representatives who see to it that Government's policies are carried out, the NNPC acts as the non-operating partner. The fundamental disparity between the two types of agreements lies in the fact that on the one side, the government has equity share holdings and on the other, it has only a participatory right to a share in the ownership and conduct of petroleum operations in accordance with its participating interest. Another area of dissimilarity lies in the fact that under the equity participation agreement a new corporate body is created, while this is not generally the case under a non-equity participation arrangement.[438]

3.5. JOINT OPERATING AGREEMENTS

In Nigeria, a JOA was signed between the NNPC and each of its joint venture partners in July 1991 right after the very protracted negotiations. Under this form of arrangement, the government participates in the ownership and authorised operations as well as shares in kind in crude oil and other products.[439] This particular type of JOA is described as a by-product of a legally and politically obligatory joint venture agreement or what some scholars has coined a mandatory or privileged joint venture.[440] Thus, in this perspective the state, as a non-operator under a free or carried participation, gains access to the resources. The state is carried free, as it does not participate in the exploration efforts in the existing acreages at the time of its beginning participation. Consequently, the JOA in respect of existing acreages is focused principally on co-sharing as regards fields, development and operating expenditure, with the state as non-operating partner sharing in the production profits

[438] Gidado (n 392) 142.
[439] *Ibid.*
[440] Thomas Walde, *The Current Status of International Petroleum Investment: Regulating Licensing and Taxing and Contracting* (Centre for Petroleum and Mineral Law and Policy 1995).

as well as the additional objective of know-how and technical information.[441] Despite the dominance of the traditional joint venture JOA, no standard JOA is established in the Nigerian oil and gas sector, and consequently co-venturers will avail themselves the advantage of numerous model forms which have developed worldwide.[442]

Akinrele's, position is that the joint operating agreement (JOA) represents the fundamental conglomerate agreement between the co-venturers and manages the relationship between them in the conduct of operations under the license. It stands as the sole source of authority between the sets of co-venturers for a definite member known as the operator, for it to carry out operations and acquire commitments on behalf of other co-venturers.[443]

Further, according to Taylor and Tyne, it is the constitution by which the joint venture is governed and performs essentially the same role as a partnership agreement or the memorandum and articles of association of a company.[444]

In addition, the JOA can also give permission to the operating committee to take decisions on a wide range of issues which are not explicitly provided for in the JOA by preponderance and which will be binding on an insubordinate co-venturer.[445]

However, there are certain matters that are not expressly within the scope of a JOA. Matters that are not within the ambit of the JOA are disposal of produced oil and gas, except perhaps to the extent of an agreement on lifting principles.[446] Similarly, the acquisition of rights to explore, appraise, develop or produce hydrocarbon

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441 Akinrele (n 430) 140.

442 The origin of the JOA dates back to form 610 devised by the American Association of Petroleum Landmarks (AAPL), which for many years was standard for onshore operations in the United States of America. In the United Kingdom a wide variety of agreements emerged from the UK licensing rounds which started in 1964 and continued to the mid-1970s. Moves were now to standardize the form in the 5th UK Licensing rounds in 1977 when the oil companies were invited to consent to a 51% carried interest to the British National Oil Corporation (BNOC). This format was confirmed after the BNOC and its successor the Oil Pipelines Agency ceased to have a privileged position. Currently, a number of variants of the BNOC format have been negotiated, even though the bulk of JOAs remain standardized around the BNOC format. See, for instance, the Progressive Partnership Working Group (PPWG) JOA http://www.pilottaskforce.co.uk. Other existing formats are the Model Form International Operating Agreement (1995) prepared under the aegis of the Association of International Petroleum Negotiators (AIPN) and the American Corporate Counsel Association (ACCA) (though not endorsed by either) and the Rocky Mountain Mineral Law Foundation's Exploration, Development and Mine Operating Agreement (Model Form 5A) (1996).

443 *Ibid.*

444 Michael Taylor and Sally M Tyne, *Joint Operating Agreements* (Longman Law, Tax and Finance 1992) 111.

445 Akinrele (n 430) 141.

446 *Ibid.*

outside the contract area to which the JOA relates, other than as a consequence of the unitisation with an adjoining area, does not fall under the ambit of a JOA.

Furthermore, under this kind of arrangement, the government does not own shares or stocks in the joint venture company and are not entitled to dividend from the company. There are a variety of these types of arrangement worldwide; these entail the formation of a working association between a transnational company and a host government or its agency without the creation of a new and separate company. The fact is that both parties agree to hold jointly all rights and interests under the joint venture agreement and meet expenses under the participating interests. A good example of a joint operating agreement is that signed in July 1991 between the Minister of Petroleum Resources with the Nigerian National Petroleum Corporation's (NNPC) partners in the NNPC/Shell Joint Ventures.

The joint venture partners are NNPC 60%, Nigerian Agip Oil Company 30%, and Elf Nigeria 5%. Shell is the operator of the joint venture.[447] Before the official signing of the joint operating agreement in July 1991, no formal joint operating agreement existed between the partners. The agreement signed in July 1991 was therefore, the first joint operating agreement to make official the working relationships between the joint venture partners.[448] The basic principle is that one of the parties, usually the transnational company, is designated as the operator of the undertaking.

This kind of joint venture was first used by Algeria in 1968 when the state oil corporation Sonatrach entered into an association with Getty Petroleum Company for the exploration and production of hydrocarbons. The Agreement depicted the association as not being a "legal entity or a corporation or a partnership save for only the juxtaposition of participation and interest according to a percentage fixed at 51 per cent for Sonatrach and 49 per cent for Getty".[449] It provided for a management

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[447] The Acquisition of Assets (British Petroleum Company Limited) Act 1979 (No. 56 of 1979), referred to in Ajomo (n 398) 92. The nationalisation of BP's assets in Nigeria was a political move against the British government's widely publicised decision to supply crude oil to South Africa. See Ajomo (n 398) 22. In 1989, the government voluntarily relinquished part of its 80% interest in Shell to establish the present partnership structure of NNPC 60%, Shell 30%, Elf 5% and Agip 5% in the NNPC/Shell joint venture. See (1991) September/October Report No. 138, World Petroleum Taxation and Legislation at 51.

[448] *Ibid.*

[449] The Agreement, governed by the Sahara Petroleum Code of 1958, except as otherwise varied by terms of the Association, provided for the transfer by Getty to Sonatrach of 51 per cent of Getty's interest in selected concessions in Algeria in consideration of a price equal to 51 per cent of the net book value of the assets and exploration values payable over a period of four years in the form of crude oil deliveries from the share acquired by Sonatrach under the transfer. For a full text of the

structure consisting of an Executive Council of four representatives of Sonatrach and three of Getty and operation by Sonatrach, with Getty (as requested by it) to furnish technical assistance and qualified personnel, the cost to be borne by the Association.[450]

3.5.1. Main Clauses in a Joint Operating Agreement

3.5.1.1 Parties' obligations in the joint operating agreement:

An archetypal JOA specifies the percentage interest of each of the licensees by separating the joint tenancy created by the licence and therefore establishing tenancy in common between the co-licensees who are parties to the JOA. There are certain provisions overriding the obligations of the parties which touch on contemplated assignment of their participating interest as well as their undivided interest in the mining leases. It has been commented that these obligations are likely to limit the independent transfer of the participating interest of the parties. That notwithstanding, such limitation possibly will not extend to the circumstances where the proposed assignee is not an affiliate of the assignor. Nonetheless, even if that is the case, the would-be assignee requires satisfying the statutory provisions of paragraph 14 to 16 of the schedule to the Petroleum Act. However, a different scenario is created where the proposed assignee is not an affiliate, and the JOA makes this absolutely comprehensible as follows:

(a) When the assigning party receives an offer from a third party which it desires to accept, it should give to the other JOA party or parties the prior rights and option in writing to purchase the participating interest and the other JOA party may within 30 days thereafter request in writing the assignment to it of the interest and such assignment must be so effected on the same terms as those offered by the non-JOA third party.

(b) If such other JOA party fails to exercise the purchase option, then the assignor may within a period of one year thereafter assign to the third party.

Agreement, see, OPEC Selected Documents 1968 253-288. Quoted in G H Barrows, *World Wide Concessions Contracts and Petroleum Legislation* (Tulsa, Oklahoma: Penwell Publishing 1983) 263.
[450]Adeniji (n 385) 166.

3.5.1.2 Identity and Function of the Operator

Under the JOA, one of the parties will be appointed as the operator, i.e. will be responsible for the day to day running of the operations. The operator typically, but not at all times, has a significant percentage interest in the license. The operator is also expected to be financially sound and technically competent.[451]

As a guide, Article 2.1 of the 1991 NNPC/Chevron JVA expressly provided for the appointment of the operator and it states as follows:

> *"A company is hereby designated, and agrees to act, as the Operators of the Concessions and Contract Area under this Agreement and hereby assumes the duties and obligations of Operators and shall have the rights of the Operators hereunder.*
>
> *The Parties acknowledge that a company has been the Operator of the Concessions prior to the Effective Date…"*

Under this kind of agreement, the foreign owned Oil Company, or in case it is more than one, one of the foreign owned oil companies, is appointed as the Operator of the joint venture. The operator is responsible for (a) the conduct of all permitted joint operations subject to the requirements of the agreement and is under compulsion to conduct the petroleum operations of the venture as a careful operator, in a good and workmanlike manner, in accordance with permitted budgets work programmes; (b) good oilfield practice; plus (c) acquiescence with applicable laws and regulations. The Operator might conduct a number of operations by itself or otherwise through its agents or contractors. Consequently, the Operator remains in charge of the operations carried out other than by it. As formally expressed, the Operator has precise duties which include:

[a] responsibility to carry out all joint Operations with utmost good faith and in a good workmanlike manner, in accordance with good industry practice and applicable Regulations, in respect of all the operations under the JOA[452] "Regulations" in Article 1 is defined as meaning

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[451] NNPC/Chevron Joint Venture Agreement (1991), Article 2.1.

[452] *Ibid,* Article 2.2.1 of the typical NNPC/Chevron Agreement partner JOA.

"all statutes, law, rules, orders and regulations affecting Oil Mining Leases in effect from time to time and made by Government authorities having jurisdiction over the Concessions and the Contract Area and over operations conducted thereon."

This duty put in a nutshell, as it were, the essential functions of the Operator as well as his obligations to the host government, its joint venture "partner", the government agencies, the environment, the communities, etc.

[b] responsibility to kindly consult with the non-operator (i.e. the NNPC) and reveal completely to it all matters of importance pertaining to the Joint Operations.[453]

[c] responsibility to present to the Operating committee in each year when considering and approving the Work Programme and Budget, the organisational chart pertaining to the management and supervisory positions of the Joint Operations.[454] It shall report on the actual implementation of the chart at such meetings.

[d] responsibility to choose its employees for the use of the joint Operations and decide their number, qualifications, hours of labour and compensation. Such employees nevertheless shall be the employees of the Operator and not of the non-operator.[455]

[e] responsibility to enter into any contract or place any purchase order subject to the limitations and restrictions imposed by the JOA, concerning services, the procurement of facilities, equipment, materials, supplies, etc.[456]

[f] responsibility to keep precise records and books of account with reference to the Joint Operations and to make them accessible to the non-operator during normal business hours.[457]

[g] responsibility to litigate and reconcile claims in correlation with the Concessions, Contract Area, or Joint Operations on behalf of the Parties in accordance to the directions of the Operating Committee; provided on the other hand that the Operator

[453] *Ibid*, Article 2.2.3
[454] *Ibid*, Article 2.2.5.
[455] *Ibid*, Article 2.2.8.
[456] *Ibid*, Article 2.2.8.
[457] *Ibid*, Article 2.2.11.

may perhaps reconcile claims not exceeding an agreed amount[458] without the endorsement of the Operating Committee.[459]

[h] responsibility to open and keep a Joint Bank Account into which the Parties shall deposit all funds required for the Joint Operations. The Operator shall confirm, obtain and forward to the non-operator on a monthly basis, copies of the Joint Bank Account statements for the previous month.[460]

[i] responsibility to build up and submit to the Chairman of the Operating Committee the proposed work programme and budgets obligatory under the Act.[461]

The operator as a matter of practice does not receive remuneration for carrying out his operatorship responsibilities. The operator shall only be entitled to reimbursement for costs incurred under budgets and programmes submitted pursuant to clause 2.3.[462] In addition, the budget shall contain only itemised and detained estimate of cost and also a charge in an amount to cover the administrative and overhead expenses charged to the operator to the head office of the operator's parent company, popularly known as the head office overhead charge.[463] It is important to note that such a charge is calculated by applying a fixed percentage to the total capital expenditure in the specific year[464].

3.5.1.3 Fiduciary Duties of the Operator

Fiduciary duties are usually invoked as implied terms of operating agreements. The nature of the equitable principle of fiduciary relationships of the operator with non-operators and the disputes arising from such relationship has not been a matter of judicial pronouncements in Nigeria.[465] Fiduciary has been defined by Professor Scott as "a person who undertakes to act in the interest of another person. It is immaterial

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[458] *Ibid*, Article 2.2.15.
[459] *Ibid*.
[460] *Ibid* Articles 1.1.20 and 2.2.16.
[461] *Ibid* Article 2.2.3 of the JOA.
[462] *Ibid* Sections 1 & 2 of the Petroleum Act (Cap. 35) are in *pari materia* with the following provisions of the aforementioned pre-independence statutes, viz., section 3 of the Minerals Ordinance 1946, and section 6(1)(a) and 6(3) of the Minerals Ordinance 1914 respectively, save that the Crown was the governing authority in the context of the latter.
[463] Akinrele (n 430) 144.
[464] Article 6.1.1(i) of the Traditional Joint Venture JOA.
[465] It has, however, been judicially considered in other common law jurisdictions excluding the United Kingdom) and been the subject matter of academic works on the position in such common law jurisdictions including the UK. See Gerald M D Bean, *Fiduciary Obligations and Joint Ventures* (Clarendon Press 1995); and Michael P G Taylor and Sally M Tyne, Taylor and Winsor on Joint Operating Agreements: Oil and Gas Law (2nd edition, Sweet & Maxwell 1992) 9.

whether the undertaking is in the form of a contract. It is immaterial that the undertaking is gratuitous."[466] Fiduciary relationship is, however, intrinsic to the relationship created by the JOA and is based on the trust conferred on the operator for conducting joint operations on behalf of the co-venturers. The operator, in dealing with the joint venture property or in entering into a contract with third parties, owes a duty to the joint venture partners and cannot acquire for its own benefit any interest in the property on the basis of the information acquired for the performance of the fiduciary duties. He will be held to be constructive trustee for any interest so acquired.[467] This is as a result of the fact that a relationship of trustee and beneficiary and that of agent and principal has started.

MacWilliamhas suggested that the courts use of "joint venture" to provide a basis on which to find a fiduciary relationship. [468] Once having so found, a breach of the fiduciary relationship will lead to the imposition of a constructive trust on the fiduciary. This was the view that was canvassed by the Supreme Court in the American case of Anderson v Stansbury[469] and the court held as follows:

> *"The imposition of a constructive trust is an equitable remedy requiring the balancing of equities and where the venture is known to the plaintiff and he does not claim his right to participate in a hazardous venture until the enterprise is successful, such delay will prohibit imposition of constructive trust."*

It would appear also that all the parties to the JOA owe fiduciary duties to one another because the relationship between the parties amounts to partnership.[470] The operator is consequently an agent of the other parties to the JOA. This was the matter that was deliberated in the Canadian case of Standard Investment Limited v Canadian Imperial Bank of Commerce,[471] and the court came to the conclusion that:

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[466] Austin W Scott, 'The Fiduciary Principle: Proceedings of the Twenty Second Annual Meeting of the State Bar of California' (1949) in D A MacWilliams 'Fiduciary Relationships in Oil and Gas Joint Ventures' (1970) 11 Alberta Law Review, Petroleum Law Supplement 234. See also Olisa (n 380) 82.
[467] *Ibid* MacWilliams.
[468] *Ibid* 233.
[469] *Anderson v Stansbury* (1952) 242 p. 2d 305.
[470] G M Lewis, 'Joint Operating Agreements: Partnership?'(1986) 4 JENRL 80.
[471] *Standard Investment Limited v Canadian Imperial Bank of Commerce* (1983) 45 OR (2nd) 16. See nevertheless, E Smith, 'Duties and Obligations Owed by an Operator to Non-Operators, Investors and Other Interested Owners' (1986) Rocky Mountain Mineral Law Institute, Proceedings of the 32nd Annual Institute 2. The writer argues that the relationship between an operator and non-operator is not one of agency.

"The common elements in a fiduciary relationship are the reposing of trust and confidence in one who undertakes to act for or on behalf of the person reposing the trust. Equity then imposes a duty on the fiduciary to act in good faith and with the regard to the interests of the one imposing the confidence."

Furthermore, it is a settled principle of law that where parties are participants in a joint venture, the courts will endeavour to find a fiduciary relationship. The mere existence of such a relationship does not, however, require one party to share the benefits of his own enterprise with another. It is abundantly clear that the interest required must fall within the scope of the fiduciary duty. In addition, if a person who undertakes to act in the interest of another person breaches his duty of undivided loyalty to that person by failing to disregard his own interest in exercising its fiduciary duty, he must account to his beneficiary for any benefit gained by him from such a breach. This was the view that was deliberated upon in Regal (Hastings) v Gulliver[472], and Lord Russell of Killowen *inter alia* gave a dissenting judgment when he stated that:

"The rule of equity which insists on those, who by the use of a fiduciary position make a profit, being liable to account for that profit, in no way depends upon fraud or absence of bona fides; or upon such questions or considerations as whether the profit would or should otherwise have gone to the plaintiff, or whether the profiteer was under a duty to obtain the source of the profit for the plaintiff… or whether the plaintiff has, in fact, been damaged or benefited by his action. The liability arises from the mere fact of a profit having, in the stated circumstances, been made. The profiteer, however honest and well-intentioned, cannot escape the risk of being called upon to account."

The common law fiduciary duties are expressly incorporated in the JOA and these are as follows:

1) *Obligation to make full disclosure of personal interest.*[473]
2) *Obligation not to use joint venture property for profit*

[472] *Regal (Hastings) v Gulliver* [1942] 1 All ER. [379], [386].
[473] See article 2.2.3 of the Standard JOA (n 452).

3) The operator must account for any interest made on money held in the joint account.

4) The operator must not misuse the information derived in confidence.

5) The operator is obliged to make an earlier disclosure of the facilities, assets, personnel if any, that might be common to the operator of such businesses or activities to non-operators and as such, the foundation for allocating the common costs, if there is any, relating thereto shall be subject to the endorsement of the operating committee.

6) Further, where the operator engages in activities or businesses outside the joint operations not being a sole risk operation.[474]

The basic underlying fact is that breach of any of these duties will give rise to liability for breach of the fiduciary duty. It invariably means that the operator occupies a position of trust in managing the affairs of the joint venture's partners. The operator must act with utmost due care and diligence in the conduct of the affairs of the joint venture partners.[475]

Moreover, there are contractual obligations that the operator can perform. For instance, the operator can enter into contracts with third parties for the purposes of carrying out joint operations. The operator in this regard has the professed authority of all the co-venturers to bind them in relation to a given activity. The standard JOA provides that the operator shall have the authority, subject to any limitations or restrictions imposed by the Operating Committee, to enter into any contract or place any purchase order.[476]

The popular view is that where the general authority exists; a third party does not need to enquire as to the operator's authority for the contract to be binding on the other co-venturers unless the third party is proven to have actual knowledge of the want of authority.[477] As a result, where the operator enters into a contract without

[474] A sole risk operation is discussed in Akinrele (n 430).
[475] Lawrence Atsegbua, *Oil and Gas in Nigeria: theory and practice*, (2nd edition Lagos and Benin: New Era Publications 2004) 97.
[476] See Standard JOA (n 452) Article 2.2.6.
[477] The concept of the operator's general authority is undiminished even where other co-venturers dissent but are in the minority where the JOA provides for majority decision-making by the JOA partners.

authority, the third party who has no knowledge of his lack of authority will not be disentitled from enforcing the contract. The operator will be solely liable under the contract and will thus be unable to recover any contribution from his co-venturers[478].

The operator's role in the choosing of contractors is subject to the 'Uniform Project Implementation Procedure.'[479] The NNPC, as a non-operator but with a majority interest which is reflected by its prevalence in the membership of the operating committee, exercises significant authority over the operator's decisions.[480] Clause 2.2.8 (v) of the standard JOA, for example, provides that "the operator shall give preference to a contractor that is a company organised under the laws of Nigeria to the maximum extent possible, provided there is no significant difference in price or quality between such contractor and other contractors". The Uniform Project Implementation Procedure provides a mechanism by which the non-operator can intervene to prevent faux pas on the part of the operator, provided this role is exercised in time. Again, this is mostly necessary in view of the contending perspectives between the operator and the non-operator under the Traditional Joint Venture arrangement. The non-operator's role in the contracting process permits it, as far as possible, to exercise its power to control costs and keep joint operations effectual and within prearranged budgets.

Furthermore, an Operator that acquires for its sole benefit an interest or profit out of the joint venture may be liable for a breach of its fiduciary duty. The courts may regard the Operator as a constructive trustee and may compel it to account to other co-owners for the benefit or interest. Professor Scott has remarked that an exact definition of a constructive trust cannot be framed and the best that can be done is to give a rough description of it. That restatement of the liability for restitution states that:

> *"Where a person holding title to property is subject to an equitable duty to convey it to another on the grounds that he would be unjustly enriched if he were permitted to retain it, a constructive trust arises."*[481]

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[478] Akinrele (n 430) 147.
[479] These procedures, which appear in Schedule D to the Standard TJV JOA, apply to contracts over a certain monetary value as set out by the operating committee in the body of the JOA. It should also be noted that the Uniform Project Implementation Procedure is subject to amendment from time to time.
[480] Akinrele (n 430) 148.
[481] *Ibid*; American Law Institute, restatement of Restitution Para. 160. (1936).

He refers also to a statement of Cardozo J of the New York Court of Appeal in Betty v Guggenheim Exploration Company[482] were it said that "a constructive trust is the formula through which the conscience of equity finds expression". He further explains that the provision in the restatement does not purport to define a constructive trust but attempts to cover so far as possible the circumstances under which a trust arises.

Also, the liability does not depend on fraud or absence of good faith or whether his co-venturer has been damaged or benefited by the action of the Operator. The rule in *Keech v. Sandford* [1726] EWCH J76 is a foundational case derived from English trust laws on the fiduciary duty of loyalty. The remedy of granting a constructive trust over property and the strict approach that all possibility of a conflict of interest was to be prevented obtained from the prevalent view at the time.

The Lord Chancellor, Lord King, directed the appellant to disgorge his profit. He explained:

> "*I must consider this as a trust for the infant, for I very well see, if a trustee, on the refusal to renew, might have a lease to himself, few trust-estates would be renewed to the cestui que use, though I do not say there is a fraud in this case, yet (the trustee) should rather have let it run out, than to have had the lease to himself. This may seem hard, that the trustee is the only person of all mankind who might not have the lease but it is very proper that rule should be strictly pursued, though I do not say there is a fraud in this case, yet (the trustee) should rather have let it run out, than to have had the lease to himself. This may seem hard, that the trustee is the only person of all mankind who might not have the lease but it is very proper that rule should be strictly pursued and not in the least relaxed, for it is very obvious what would be the consequence of letting the lease, on refusal to renew the cestui que use so decreed, that the lease should be assigned to the infant and that the trustee should be indemnified from the covenants comprised in the lease, and an account of these profits made since the renewal.*"

[482] [1919] 225 NY 380 at 386.

This was the view that was canvassed in the case of *Soar v Ashwell* where the trial judge, Lord Justice Bowen, held with regard to a constructive trust that:

> *"A constructive trust is one which arises when a stranger to a trust already constituted is held by the court to be bound in good faith and in conscience by the trust in consequence of his conduct and behaviour. Such conduct and behaviour the court considers as involving him in his duties and responsibilities of a trustee, although but for such conduct or behaviour he would be a stranger to the trustee. A constructive trust is therefore, as has been said a trust to be made out by the circumstances."*[483]

It is trite law that it is imperative to recognise that a constructive trust is a flexible remedy resembling a trust that arises by operation of law as a response to certain events that are normally termed a wrong. For this reason, the most remarkable aspect of a fiduciary relationship is the strict rule that a fiduciary may not keep any unauthorised profit arising from a position where there is a probability of conflict of personal interest and duty to their beneficiaries. Rather, the trustee must disgorge such profit by way of constructive trust, whether or not it was made at the cost of the trust. See generally the case of *Boardman v Phipps* [1967] 2AC46.

This is particularly so as he is in a dominant position, at any rate in the Nigerian context. However, an operator which observes and performs its duties and obligations in accordance with the provisions of the operating agreement will not be accountable for breach of its contractual duty or its fiduciary duty since it is doing no more and no less than observing the provisions of the Agreement.

3.5.1.4 Operator's Liabilities

The operator's fundamental function under Art 2.2.1 is to conduct all Joint Operations with utmost good faith, in a workmanlike manner and in accordance with good industry practice. A corollary or converse of this is that the Operator would be

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[483] *Soar v Ashwell CA* [1893] 2 QB 390.

liable to the non-operator if it failed to conduct the Joint Operations in the manner and to the standard required under Art 2.2.11.

In Art 2.2.2., it is provided that the Operator or its affiliate shall not be liable for any loss or damage which results from "Wilful Misconduct" on the part of its Directors or supervisory staff,[484] provided that under no circumstances shall the Operator or its affiliate be liable to the non-operator for reservoir damage or pollution or for any consequential losses whatsoever or howsoever occurring.

"Wilful Misconduct" in relation to the Operator means:

> *"an intentional and conscious reckless, or wanton disregard of any material provision in the JOA or any substantial part of the agreed programme of operation, but does not include a situation where the operator acts in compliance with the instructions of any governmental authority or in pursuance, in good faith, of a decision of the operating committee, or relates to safeguarding of life, property, or joint operations, or any error of judgment or mistake made in the exercise, in good faith, of any function, authority or any discretion conferred upon the operator."*[485]

In this context, it is submitted that, the operator being an agent of the non-operator, there is no reason why its acts and relationship with the non-operator would not be governed by the general principles of the law of agency. It is noteworthy that in most operating agreements, the liability of the operator is limited to wilful and wanton misconduct but to prove liability has time and again been shown to be complicated and, as a consequence, uncommon.

3.5.1.5 The Operating Committee

The Operating Committee is established by the parties to the operating agreement for the objective of providing organised broad supervision, control and direction of all subjects pertaining to the joint venture operations and shall be established within 30 days of the first execution. The Operating Committee is not a characteristic of all operating agreements outside Nigeria. In a number of past operating agreements which did not have an Operating Committee, specifically in the United States and

[484] *Ibid*, Article 2.2.2.
[485] *Ibid*, Article 1.1.34.

Canada, the operator was given exclusive control and management of the joint venture operations or of those joint operations equally agreed to by the co-venturers. This provision tends to bestow upon the operator a degree of control which is really superior to the participating interest of the operator. In a number of operating agreements without operating committees, functions delegated to the operator include control and management of the explorations, development and operations of the joint lands for the joint account subject to free and frank consultation and disclosure to non-operators with respect to all decisions regarding the conduct of all joint operations.

It should be noted that in such operating agreements, none of the parties is in any central position vis-à-vis the others in terms of technology, knowhow and the expertise required for the conduct of resourceful petroleum operations. Nevertheless, the trend in more topical operating agreements is that the operator holds his position as long as the majority in the interests of the parties want him to do so, and he may well be removed with or without cause or wrongdoing on his part by the majority.[486]

As the case may be, the Operator typically acts or acts under approval of the Operating Committee in respect of:

(i) approval, revision or rejection of all proposed work programmes and budgets;[487]
(ii) determination of the selection, scope, timing and location of all wells and facilities for joint operations as well as changes in the use or status of any such wells; [488]
(iii) consideration and decisions on matters relating to the addition or reduction of the contract area;[489]
(iv) settlement of claims exceeding $300,000 (or its equivalent in foreign currency), where such claims are not covered by policies of insurance maintained for the joint account;[490]
(v) consideration of universal matters relating to general policies, special studies, research, procedure and methods of the joint operations;[491]

[486] J A Maclean, 'The Canadian Association of Petroleum Landmen Operating Procedure: An Overview of the Revisions', (1992) XXX(1) Alberta Law Review, Petroleum Law Edition 133, 143.
[487] *Ibid,* Article 3.1 (i). Of the typical NNPC/ J.V partners JOA.
[488] *Ibid,* Article 3.1 (ii).
[489] *Ibid,* Article 3.1 (iii).
[490] *Ibid,* Article 3.1 (iv).

(vi) the abandonment and storage of joint property or any portion thereof;[492]

(vii) Ensuring that the operator implements the provisions of the Uniform Accounting Procedure (Schedule 'B'), the Uniform Project Implementation Procedure (Schedule 'C'), the Uniform Nomination Scheduling and lifting Procedure (Schedule 'D') and all amendments and revisions thereto as agreed by the parties.

The JOA, in summary, gives a high degree of control to the operator such that it carries out the joint operations by itself, its agents or its contractors under general supervision and control of the joint operating committee.[493]

The operating committee generally consists of at least one representative of each of the co-venturers. Under the Nigerian JOA, the operating committee is made up of ten persons appointed by the co-venturers, six persons representing the NNPC and four persons representing the operator with a quorum of five persons (three from the NNPC and two from the operator). The non-operator appoints the chairman of the committee and the operator appoints the secretary (who need not be a member of the operating committee) to keep minutes and records of all actions and decisions of the operating committee. The operating committee meets once every four months or at regular intervals or by request of any of the co-venturers.

Decisions of the operating committee are to be made by resolute vote of the parties and this ensures that the non-operator has a veto power over any proposed action of the operator to which it objects. Nevertheless, other JOAs provide for majority decisions and in some non JOAs, such powers of veto are intrinsically limited so that the operator may be permitted to override normal voting procedures for work programme approvals, mainly where the licence requirements for the fulfilment of drilling programmes need to be met. It is acknowledged that the reason why such a facility does not exist in the framework of the Nigerian JOA is that the NNPC, being

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[491] *Ibid* Article 3.1 (v).

[492] *Ibid* Article 3.1 (vi).

[493] This position is similar to the BNOC proforma JOA, which was imposed from the mid-1970s when the policy of State participation in the UK was being implemented. In the 1990s, CRINE provided for a relaxation in the degree of control of the operators' functions based on the need to save costs. This should be contrasted with the position under the AAPL form 610 where there is no provision for an operating committee. In the latter context, non-operators look to the wide powers of 'non-consent' afforded them under this form of the JOA in order to object to the operator's proposals as regards operations. Quoted from Akinrele (n 430).

an agency of the State, which acts in a quasi-regulatory capacity, is believed to be aware of its responsibilities under the licence.[494]

Similarly, the JOA also makes provision for committee decisions to be made without the need to call a meeting, if such matter is submitted by the chairman on his own proposal or at the application of any party or, in the case of pressing issues, by the operator. Such notice will contain enough information regarding the issue to be determined so as to enable the parties to make a knowledgeable decision with respect to such issue.[495]

Financial controls are exercised by the operating committee firstly in the course of the approval of programmes and budgets put forward by the operator and secondly through the process of authorisations for expenditures (AFE). The former, i.e. the budget, is always a rough estimate whereas the latter symbolise a more precise financial control which is prepared by the operator when it has determined more precisely the probable costs of certain services or operations.

It is worth noting that the supervisory role of the operating committee is fundamental to the effective running of the JOA. It invariably means that if the committee fails to discharge its duty conscientiously, the operator will assume a dominant role in the JOA. This situation more often than not poses huge problems for the joint venture partners. Thus, the operating committee acts as a check to, and balances the role of the operator.

3.5.2. Insurance Aspects of a JOA

The insurance provisions in the Operating Agreement are very adequate; the scope of risks covered is wide and the limits of coverage in each category of policy are appropriate. Each party shall take out and maintain, at its sole cost and expense and in respect of its participating interest, insurance with respect to physical damage to property whether onshore, offshore or in transit for the full re-instatement value on an All Risks Basis and to include well control. Also, the Operator has to take out and maintain for itself and for the non-Operators and pay for and charge to the joint account of the joint venture, wide ranging classes of insurance.

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[494] *Ibid* 151.
[495] *Ibid* Article 3.5.

The insurance maintained by each party shall not prejudice any insurance obtained by the Operator for the joint account of the joint venture and shall include a waiver of subrogation in favour of other parties to the agreement. The policy should also provide for each other party to be given not less than thirty days prior notice of cancellation so that such other party may take steps to protect its interest, such as payment of any outstanding premium on behalf of the party in default of premium payment.

The responsibilities of the Operator are enormous as far as insurance is concerned. The insurance maintained by the Operator must name non-Operators as additions or co-insured and underwriters must waive all rights of subrogation in favour of non-Operators and their respective affiliates, directors, servants, agents and employees.

3.5.2.1. Operator's Undertakings with regard to Insurance

The Operator undertakes to: -

(i) use its best efforts to require its contractors and sub-contractors to maintain such types of insurance and within limits of accounts as the Operator deems fit with respect to joint operations;[496]

(ii) ensure that the insurers furnish non-Operators with certificates of insurance (and renewal thereof) obtained and maintained by it pursuant to the agreement and with a summary of details of the policy evidenced by each certificate; and

(iii) Take sole responsibility for any loss, claim, demand or damage arising from its failure to take out and maintain any of the insurance policies which the Operator is obliged to take out pursuant to the agreement except where the Operator has used all reasonable endeavours but has been unable to do so and has promptly notified the non-Operator(s).[497]

3.5.2.2. Sole Risk Operations

Sole risk simply means an action performed by only one of the party as enshrined in the provisions of article 8 of the JOA. The basic underlying purpose is to differentiate between those operations where the decision of the operating committee has been

[496] Olisa (n 380) 93.
[497] Akinrele (430) Article 5.2.3 for offshore operations.

unanimous,[498] and to help in determining the issue of which operations to undertake where a common decision cannot be reached. In the latter case, there is clearly a risk that the whole operation will come to an end; the JOA however, tries to mediate such an impasse through providing for the taking of sole risk, whereby the contentious operation may be undertaken by one of the co-venturers at its own cost and risk and for sole profit.

In the first instance, the provisions for a sole risk operation lay down a mechanism for a party to a joint venture agreement to avail himself of a common law right of co-tenancy, which is the right of use and enjoyment of the common property provided he does not oust any of his co-tenants and provided further that he accounts to his co-tenants to the extent of their respective interests in the common property. However, the common law obligation of accounting to his co-tenants is still very much adapted by the sole risk provisions.

Secondly, the party who is bearing the entire risk and costs of sole risk operation should be provided with a reward proportionate with the risk taken. It is only if the sole risk party or parties obtain production that the matter of reward arises.[499]

Certain conditions apply to sole risk operations. As a universal rule, no sole risk operations may be planned or undertaken except when conditions prescribed in the operating agreement are fulfilled. One significant condition is that the proposed operations must not unfavourably affect and are not in conflict or capable of conflicting with any joint operations of all the parties. The additional condition is that the activities that may be performed as sole risk operations are limited to those listed in the agreement. That is the uniform Joint Operating Agreement in use in Nigeria. Such activities may include the following activities:

(a) the deepening, side tracking or plugging back of an Exploratory Well;
(b) the drilling of an Exploratory Well including testing and coring programmes;
(c) the drilling of evaluation and development wells and the installation of production facilities to develop a discovery made by a Sole Risk Exploratory Well, provided the rationale (of the production facilities) is not to increase or step up production from any other geological structure than the one on which the sole risk exploratory well was drilled; also

[498] Akinrele (n 430) 155.
[499] Olisa (n 380) 95.

(d) Any other activity or project agreed by the Parties to be carried out as a Sole Risk Operation.[500]

It would appear that if the operating agreement establishes an operating committee, it follows that when a sole risk operation is being contemplated, a written proposal in complete form for that sole risk operation must be initially made to the committee. The basic underlying principle is that the written proposal must state apposite details of the operation such as the location of a proposed well, purpose of the operation, the scope of geological and geophysical programmes, proposed depth, enumerated estimate of the costs thereof, economic analysis and expected dates of commencement and completion. It can be argued that a proposal for sole risk operations is not permitted for deepening or side tracking an exploratory well at the same time as drilling is in progress unless the well has not run into a discovery and the parties are determined to discard the well.

A further mechanism for undertaking sole risk operations is for a party to give to other parties a sole risk notice in writing within periods specified in the agreement.

In some operating agreements, a party which elects to participate could do so either for its working interest or for its proportionate share of all available interests. If there is any surprising interest, the proposing party would have to assume it or else it could be allocated proportionately to the participating parties or by any other arrangement as the agreement may provide. A maximum limit may be set on the maximum percentage interest that a party may have in the sole risk operations.

Furthermore, as among the participating parties, the provisions of the operating agreement relating to the duties as well as rights of the operators along with the rights and obligations of non-operators shall apply mutatis mutandis to the conduct of the sole risk operations, the accounting consequently and to the operation of any well during the recovery of costs and penalties with respect thereto.[501]

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[500] Clause 8.2 of the Uniform Joint Operating Agreement. In the Agreement, the definition of "Exploratory Well" is technical. For the present purpose, a simple definition will suffice and that is: "a well drilled in unproven or semi-proven territory for the purpose of ascertaining the presence underground of a commercial petroleum deposit." See H R Williams and C J Meyers, *Manual of Oil and Gas Terms*, (2nd edition, New York: Matthew Bender & Company Incorporated 1964) 148.
[501] Olisa (n 380) 97.

Also, a number of the participating parties may not wish the operator to carry out the sole risk operations if they are of the opinion that the proposing party could carry out the operations proficiently for the cost set out in the notice or proposal for sole risk operations. To provide for such a situation, some operating agreements have provisions under which one of the participating parties will become the operator of sole risk operations.

Before long, as the prescribed period of election to participate terminates or as soon as the parties have replied to the sole risk notice, the proposing party will without delay give notice to all participating parties stating how the costs, risks and benefits are to be borne or shared. The operator of sole risk operations must keep and maintain separate books, records and accounts with respect to these operations and the participating parties shall have the right to examine and audit the books, records and accounts.

There is a growing recognition that a party not participating in sole risk operations may well subsequently elect to participate in the operations, but he has to pay a penalty for so doing. This penalty is typically of one of two kinds, namely a production penalty or a cash penalty. However, the uniform operating agreement presently in use in Nigeria provides for a cash penalty; a non-participating party may at any time, elect to participate in sole risk operations by paying to the sole risk party any amount equal to its participating interest share of the cumulative cost and expenditure of the sole risk operations incurred as of the date of the election plus 200% thereof as re-entry penalty. The re-entry penalty must be paid in cash in the currency in which the sole risk costs were earned. The agreement also provides an alternative for payment "in kind" as the parties may jointly agree. It has been observed that with regard to the re-entry penalty, the agreement makes no distinction between an exploratory well and a developmental sole risk drilling.

3.5.2.3 Separate Books, Records and Accounts:

The Operator shall keep and preserve separate books, records and accounts (including bank accounts) regarding the Sole Risk Operation[502] (Art 8.7.2.). In this connection, the Sole Risk Party shall be obligated to advance the estimated

[502] *Ibid*; Uniform Joint Operating Agreement., Article 8.7.2.

expenditure for the Sole Risk Operation to the Operator within fifteen days after receipt of the Operator's request.[503]

3.5.2.4 Election of Non-Participating Party to Participate in Further Work:

A non-participating Party may at any time, elect to participate in a Sole Risk Operation by paying to the other Party, an amount equal to its Participating Interest share of the cumulative cost and expenditure of the Sole Risk Operation, incurred as of the date of such election plus 200% thereof being a re-entry penalty.[504] (Art 8.10).

3.5.2.5 Use of Joint Property and Personnel of Operator:

The Sole Risk Party shall be permitted the use of Joint Property and the Operator's personnel for the operation; provided however that at all time, the Joint Operations shall take precedence over the Sole Risk Operation.[505] In all such operations the Sole Risk Party shall indemnify and hold free and harmless the non-Participating Party against all suits, claims, liens, liabilities and damages directly or indirectly caused to third parties or earned by the Non-Participating Party arising from anything done or omitted to be done in the course of the Sole Risk Operation.[506]

3.5.2.6 Entitlement to the Sole Risk Operations, Production and Facilities:

(i) Typically, all property obtained through a Sole Risk Operation, including data and information, is possessed entirely by the Sole Risk Party, subject to no participation election by a Non-Participating Party having taken place.[507]

(ii) Where participation by a Non-Sole Risk Party occurs later, the petroleum and the facilities up to the time of such happening are owned by the Sole Risk Party.[508]

(iii) Despite the election of a Non-Sole Risk Party to participate in an operation connecting production of petroleum discovered as a result of a Sole Risk

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[503] *Ibid,* Article 8.9.
[504] *Ibid,* Article 8.10.
[505] *Ibid,* Article 4.11.
[506] *Ibid,* Article 8.12.
[507] *Ibid,* Article 8.13.
[508] *Ibid,* Article 8.13.2.

Exploratory Well, and the payment by the Non-Sole Risk Party of the amount referred to in Art 8.10, the Non-Sole Risk Party shall not be entitled to receive any payment in kind or cash or credit for any petroleum which was produced as a result of a discovery from such Exploratory Well prior to the date of such election to participate and such payment. Upon such election and payment, however, such Non-Sole Risk Party shall be entitled to its Participating Interest share of the petroleum produced as a result of a discovery from such Exploratory Well following such election and payment.[509] (see Art. 8.13.3).

3.5.3 Other Provisions of the JOA

A number of other provisions are contained in Article 6.2. Of the Standard Nigerian JOA:

3.5.3.1 Force Majeure.

No Party shall be liable in respect of any delay in completion of work hereunder or of the non-performance of any term or condition of this JVA directly or indirectly resulting from delays by Acts of God; acts of the public enemy; strikes; lockouts; epidemics and riots; power failure; water shortage or adverse weather conditions; or other causes beyond the control of the Parties. In the event of any of the foregoing, the time for performance shall be equitably and immediately adjusted, and in no event shall any Party be liable for any consequential damages from its performance or non-performance of any term or condition of this JVA. The Parties shall resume the completion of work under this JVA as soon as possible following upon any delay due to force majeure.

3.5.3.2 Funding of Joint Operations:

The parties contribute funds in the proportion of their respective undivided percentage interest towards costs and expenses obligatory for standard operations under the operating agreement. The customary practice is that the operator is at liberty to levy an overhead charge under the JOA, of 2.5 per cent of total capital expenditure, representing the input made available by the experience of its head office staff.[510] It must be stressed that in these circumstances, the practice of levying

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[509] *Ibid,* Article 8.13.3.
[510]This has been the subject of much resistance in some jurisdictions such as in the UK, where UK-based staff now have all the experience required to conduct UKCS operations and some, though not

the overhead charge does affect the ability of operators to include in their costs appropriate levels of ordinary overhead costs, such as benefits for personnel and the costs of running offices. The object of the accounting procedure is to ensure that the operator's actual costs are covered and that he shall neither gain nor lose in acting in such a capacity under the JOA. Not later than 15 days prior to the day of the calendar month in which specific costs and expenditures are to be made, the operator shall submit to each non-operator its respective "cash call"[511] for such month.

3.5.3.3. Cash Calls:

As enshrined in the JOA provisions, it is obligatory that the operator shall be well funded at every period by expressly providing that:

> *"the operator shall, not later than ten (10) days prior to the first day of the cash call month, submit to each party: (a) an itemised estimate of such cost and expenditures, termed 'estimated expenditures' as well as an itemised return of the actual expenditures for the month, termed the 'actual expenditure month,'*[512] *two months preceding the cash call month; (b) an itemisation of the cash available or cash deficit in the joint bank account as the case may be as of such date as well as any credit expected to be received in the cash call month and; (c) such party's cash call for cash or deficits and credits in (b) above."*[513]

Furthermore, as enshrined in articles 6.2.3 and 6.4, each party is required to pay its individual cash call into the joint bank account not later than the due date, which is the first day of the cash call month. In addition, all payments and receipts pertaining to joint operations are made into the joint account, which is governed by the rules set out in the extensive uniform accounting procedures comprised of three annexes,

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all, operators have agreed to withdraw the parent company overhead. This can be contrasted with Nigeria where the parent company overhead remains applicable, notwithstanding the fact that a proper fulfilment by the operator of its obligations under paragraph 37 of the First Schedule to the Petroleum Act, Para. 12-30/A28 and Regulation 26 of the Petroleum (Drilling and Production) Regulations, Para. 21-010/A16 *et seq*, post provides for the implementation of a detailed programme of recruitment and training of Nigerians in all phases of petroleum operations.

[511] "Cash call" means the amount in all currencies which the Operator estimates a Party must pay into the Joint Account in a given month to meet such Party's Participating Interest Share of the costs and expenditures to be paid for the Joint Account in such month, after adjusting for balances and deficits in such Joint Bank Account as well as any credit receipts anticipated during the month.

[512] *Ibid,* Uniform Joint Operating Agreement, Article 6.2.1a.

[513] *Ibid,* Article 6.2.1b and c.

specifically the Uniform Accounting Policies, the Uniform Accounting Reporting Manual and the Uniform Budget Reporting Manual.

It can be argued that a cash call may be disputed by the non-operator[514] if the likely expenditures to be sensibly incurred by the operator have been exceeded, although such difference of opinion cannot extend to costs incurred for the protection of life and property, pollution prevention or action taken in matters of accidents or emergencies. In such situations, where there is a disagreement, the undisputed portion of the cash call shall be paid by the non-operator into the joint bank account not later than the due date. In this view, a stipulation is also made for payments of joint operating expenditure approved between the parties in accordance with NNPC's typical evaluation procedures[515] or any other basis decided by the parties[516] through a technique for payment of the cash call in crude oil in lieu of cash, which can be generated by a notice or by the failure of a party classified as an 'overdue party'[517] to pay the cash call.[518]

The *modus operandi* of cash calls may result in excesses in the joint operating account, possibly giving rise to the managerial burden on the operator of having to account for excesses and interest payments. Nevertheless, this is viewed as an essential trade-off for the need to secure, in advance, sufficient funding to meet operational overheads.

3.5.3.4 Cash Call Default:

In a situation where a party fails to pay its cash call by the due date or fails to inform the Operator of its plan to pay a cash call in crude oil, the Operator shall, on notice to the defaulting party and the Operating Committee, request a meeting of the Committee to resolve the default or take any other decision. Such decision will be binding on the parties.

The JOA provides that:

[514] *Ibid,* Article 6.2.4.
[515] *Ibid,* Article 6.4.
[516] *Ibid,* Article 6.5.
[517] The basic fact is that the valuation of the lifting when the party is overdue is based on the Platts Oilgram, a Global service providing newsletters and reports on the Global Oil Industry.
[518] Akinrele (n 430) 153.

"If a party fails to provide a notice pursuant to Article 6.2.2 and fails to meet its cash call by the due date specified in Article 6.2.2; and the liftings available to the non-defaulting party pursuant to Article 6.4[519] *are inadequate to meet its cash calls, such party shall become a "Defaulting Party".*[520]

If the default is overdue by two months, then the operator shall, on the approval of operating committee, borrow funds to meet the amount in default in accordance with the decision of the operating committee; pursuing any other remedy obtainable according to the law; suspending or limiting joint operations including those relating to the defaulting party's participating interest share of production. Where the non-defaulting party is the non-operator, then the said party can defer payments of its cash calls, provided in each case that the party not in default first gives notice to the applicable governmental authorities. Analogous default provisions also apply in circumstances of major projects, such that crude oil can be applied for major project cash call defaults.

In further types of JOA, stipulations will be made where there is default by one or more of the licensees for the non-defaulting party to step in to meet the defaulter's share of present and future expenditures. This is expediently termed, 'an additional cash call' and it may probably (in addition to the obvious claim for reimbursement) in most cases, build up to rights to compensation by such non-defaulters for carrying the defaulting party as well as an array of sanctions.[521]

What happens outside Nigeria when there is default by a party in payment of a cash call or cash advance under the operating agreement is that the non-defaulting operator is given a lien on the participating interest share of crude oil belonging to the defaulting party for the recovery of the cash call or advance and interest thereon. In the Oil and Gas industry in Canada, for example, clause 505(b) provides that

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[519] Article 6.4.of the Standard JOA (n 452).

[520] Article 6.5.1.of the Standard JOA (n 452).

[521] This has been the case with U.S. JOAs as well as many early JOAs in the UKCS. In the U.K, a lien on the defaulting party's share of joint facilities and production of petroleum, cannot be taken, owing to difficulties on registration of such liens as floating charges as they are categorized in the U.K. The current JOAs based on the BNOC proforma provide that during the continuance of the default, the defaulter losses his right to attend, receive information and vote at operating committee meetings. In cases where a default persists for more that six working days, the defaulter shall not be entitled to its share of petroleum until the default is remedied and the non-defaulting party is given a concomitant right to an assignment of the beneficial ownership (in proportion to the non-defaulting party's share of the facilities and production) free of encumbrances as regards the interest of the defaulting party in the production license under the JOA (subject to the consent of the Secretary of State).

"The operator's lien attaches to the all costs and expenses incurred for the joint account, not only costs and expenses pertaining to the joint operations, as well as the case in subsection 505(a) of the 1981document."

The ultimate action that may be taken under the Nigerian Standard Operating Agreement is to suspend payments of their cash calls or otherwise curtail or suspend joint operations after the parties that are not in default shall have notified applicable Government authorities.[522]

3.5.3.5 Cessation of Operatorship:

There are certain situations that deteriorate to cessation of operatorship under the JOA. Conditions that can spark off such a termination are as follows:

(a) where the operator assigns or purports to assign its interest to a non-affiliate company or where the operator assigns its general powers to an affiliate company, in addition to such assignment the said company ceases to be an affiliate;

(b) where the Operator ceases or threatens to cease to carry on its business or becomes bankrupt or insolvent or commits or suffers any act of bankruptcy or insolvency or makes assignment for the benefit of creditors;

(c) if the Operator defaults in its duties or obligations or any of them and fails to commence to rectify the default within the number of days specified in the agreement after written notice from other co-venturers specifying the default and requiring the Operator to remedy the default;

(d) if the Operator ceases to own, hold or represent any participating interest in the joint venture;

(e) if the affiliate to whom the Operator has assigned general powers and responsibilities of supervision and management as Operator ceases to be an affiliate of the Operator; or

[522] Olisa (n 380) 90.

(f) if the party acting as the Operator (or any affiliate of the Operator which is a party) assigns or else disposes of, other than to an affiliate, all its participating interest in the joint venture.

Termination of operatorship or the taking away of the Operator for any of the acts of breach or failure just specified will not take effect if the Operator commences, within twenty-eight days from the receipt of the notice to remedy the breach complained of in the notice and completes the same within a reasonable period, or within the same period, gives notice of arbitration as provided in the Agreement or until ninety days from an arbitration determination that the Operator has committed the breach or failure. Where the Operator has not referred the dispute to arbitration or has taken no steps to cure the breach of failure, the removal of the Operator will not take effect pending sixty days from the date of a joint notice given by non-Operators to the Operator.

It has been commented that in some operating agreements which are employed outside Nigeria, there is a provision usually known as "Challenge of Operator." Under such provision, so far as the Operator is not engaged in the drilling, completion or abandonment of a well for the joint venture account, and the Operator has acted in such capacity for a continuous period of two years, a non-Operator may, by notice in writing, inform the Operator of more favourable terms and conditions under which such non-Operator is prepared to act as Operator.[523]

Having received a "challenge", if the Operator is incapable or indisposed to match the terms, costs and state of affairs as set out in the challenge notice, then within a period of six months from the date of receipt of the notice, the Operator shall advise the non-Operator that gave the notice of its intention to quit the position of Operator and then must quit within a ninety days after it so advises the non-Operator that gave the notice.[524] If the non-Operator becomes the Operator as a consequence of the challenge notice, it ought to immediately go on to carry out operations as the Operator in accordance with the undertakings made in the notice, as a result of which any costs in excess of those specified in the notice shall be for the new Operator's sole account.[525] The new Operator shall not resign from the position of Operator until it has acted as Operator for a period of at least two years provided

[523] *Ibid* 84.
[524] *Ibid.*
[525] *Ibid.*

that none of the conditions for automatic subrogation of an Operator takes place, such as, bankruptcy, cessation of business, failure to commence and continue the minor adjustment of default on the part of the Operator and the decreasing of its participating interest in the joint venture below an exact percentage. The underlying principle is that the "Challenge of Operator" provision is rarely ever invoked in practice. In those operation agreements in which it is incorporated, it is there to serve less as a control than as an additional disincentive to the Operator to open itself to the risks of a challenge.[526] In the light of the fact that throughout the history of joint ventures in developing oil producing countries one consistent policy of transnational oil companies appears to be that they, instead of the host countries' national oil company, are the operator, some commentators have argued that an attempt by the State-owned Oil Company to vest such control will be seen as usurping their position and be seen as wholly or partially diminishing the business of the transnational companies and ultimately reducing their position to that of mere investor.[527]

3.5.3.6. Assignability of Interest Right:

It is expressly provided[528] that every party shall have the right at any time to transfer in whole or in part, its participating interest in the assets, joint property and working capital including its rights, title, interest and benefits, duties and obligations under the JOA. The exercise of this right is, nevertheless, based on the following circumstances:[529] that no party may assign or transfer its interests without the prior written consent and approval of the other party or parties, which consent shall not be unreasonably inoperative;[530] any assignee or transferee shall be of a technical and financial standing adequate to carry out the duties and obligations under the JOA and to meet liabilities to the point of the interest assigned or transferred to it;[531] the

[526] *Ibid* 85.
[527] See provisions of JOA Agreement as provided for by the participation agreement. (Usually, signed between NNPC and each of its joint venture partner in July 1991.) Section 2.7. It is important to note that it is the right of the corporation to operator-specified portions of the joint venture not the whole of it, as is the case of the multinational operator; secondly, the petroleum joint venture between the operating company and the corporation has been going on since April 1973 with the transnational as the operator and thirdly, by section 2.7, the NNPC has forfeited its common law right as a co-tenant to operate any part of the joint land so long as it does not oust the co-tenant and that such forfeiture can last until the last producing well in the joint venture ceases production permanently.
[528] *Ibid,* Article 19.1.
[529] *Ibid,* Article 19.1.
[530] *Ibid,* Article 19.1.1.
[531] *Ibid,* Article 19.1.2.

transferring party shall have completely performed all of its duties and obligations under the agreement up to the effective date of the assignment etc.[532]

There are also instances where the co-licensee is assigning all or part of its interest to an associated or affiliated company which it controls, or which is prescribed by a common parent company in order to aid re-structuring within its group of companies. In this regard, subject to the necessary governmental consents, such assignments rarely prove to be controversial. The assignment to a non-affiliated third party nevertheless requires that the transferor give notice to the co-licensee, giving him the earlier right and option in writing to purchase such participating interests.

The following articles buttress this point:

> *"19.4.1 The Transferring Party shall first give a notice to the other Party specifying within it the name and address of the aforementioned third Party and the terms and conditions (together with monetary; and other consideration) of the proposed assignment and transfer.*
>
> *19.4.2 Upon receipt of the notice referred to in Sub clause 19.4.1, the other Party may, within thirty (30) days thereafter, request in writing the assignment and transfer of such Participating Interests to it, in which event the assignment or transfer shall be made to it on the same or equivalent terms.*
>
> *19.4.3 Where the other Party does not call for the assignment or transfer of such Participating Interests to itself as in Sub clause 19.4.2 above, the Transferring Party may, within a period of one year subsequently, assign or transfer such interests to the said third party provided that an instrument evidencing such transfer must be issued by the parties thereto and offered to the non-transferring Party."*

As a result, no assignment to a third party can take place except the assignor originally offers the right of initial refusal to the other party or parties to the JOA to obtain the interest being assigned, which right ought to be exercised within 30 days. The basic truth is that Rights such as this, with the intention of enabling the parties to enjoy a first choice over third parties, may possibly have the practical shortcoming

[532] Akinrele (n 430) 175.

of causing difficulties with regards to negotiations for an assignment, as third parties may be unwilling to negotiate detailed terms once they are conscious that a co-venturer may possibly exercise a pre-emption right. Under the JOA, because the non-transferring party has only a period of 30 days in which to exercise its option to acquire, it is deemed a commercially satisfactory period for a third party to await the determination as to whether such an option will be exercised (after it has negotiated and made its offer to the transferring party).

It has been commented that in the framework of non JOAs, provisions for longer periods in which a non-transferring party is to exercise its pre-emption rights may be a disincentive to third parties who cannot afford such extensive periods of improbability. This problem is quite noticeable in a number of oil and gas jurisdictions where pre-emption periods from 60 to 90 days or even longer exist.

It has also been argued for the additional provision in Article 19.4.3 of the JOA for a one-year period, commencing after the decision of the non-transferring party not to exercise its right of pre-emption, taking into consideration the need of the third party assignee for enough time to act in conformity with the assignment provisions under paragraphs 14 to 16 of the first Schedule to the Petroleum Act, whereby the previous endorsement of the Minister of Petroleum to the assignment must first be sought upon the recommendation of the Director of Petroleum Resources. Such a provision recognises that failure to obtain this consent may lead to a cessation of the licence. Consequently, the JOA provides that pending the required government approvals, no assignment will be obligatory and further that there shall be a written instrument amongst the parties and the assignment duly implemented by the assignee accommodating all of the obligations under the agreement.

3.5.3.7 The Governing Law:

On the question of which law will govern the joint venture operations, all Nigerian Participation Agreements state unambiguously that the Agreements "shall be construed, interpreted and governed in accordance with and by the laws of Nigeria." However, the position is different as regards views as to which Arbitration Law shall preside over disputes occurring between co-venturers. Each and every one of the Nigerian participation agreements, with the exclusion of the one between NNPC and Shell/Agip/Elf (NNLG Ltd) states that the Arbitration Laws of Nigeria shall be the *de* *jure* law that is applicable. With regards to the NNPC and Shell/Agip/Elf Agreement, the clause relating to the applicable law for arbitration is as follows:

> *"The Government of the Federal Republic of Nigeria having ratified the Convention on the Settlement of Investment Disputes between States and Nationals of other states, the parties hereto shall submit all disputes arising out of this Agreement to Arbitration before the International Centre for Settlement of Investment Disputes between States and Nationals of other States (ICSID), subject to the jurisdiction and the arbitration procedures of the said Convention and rules of ICSID.[533]"*

From the foregoing it can be deduced that one possible reason that can be offered for such marked difference in the terms of Arbitration Law between this Agreement and others which preceded it may be that Nigeria had just ratified the ICSID Convention. The legal framework for arbitration in Nigeria is provided for in the Arbitration and Conciliation Act.[534] The Act is based on the United Nations Commission on International Trade Law (UNCITRAL) Model Law and applies throughout the Nigeria Federation.

Generally, Nigerian courts are well-accustomed to arbitration and maintain a pro-enforcement bias with regards to the enforcement of arbitration agreements and arbitral awards. Notably, in Onward Enterprises Ltd v MMV Matrix,[535] the Court of Appeal held that: "Once an arbitration clause is retained in a contract which is valid and the dispute is within the contemplation of the clause, the court will give regard to the contract by enforcing the arbitration clause. It is therefore the general policy of the court to hold parties to the bargain which they freely entered"

The court took a radical view in the recent case of Continental Sale Limited v R Shipping Inc, where the Court of Appeal held as follows:

1. The spurious argument that service of notice was not in writing cannot fly.
2. Email is a form of communication that is set down in writing. It is not oral. The fact that it is electronic is immaterial. It is not in thin air. It can be downloaded and is as real as a hard copy of the letter or mail in your hand.

[533] Clause 40 (1) of the NNPC and Shell/Agip/Elf (NNLG Ltd) Participation Agreement 45.
[534] Cap A18, Laws of the Federation of Nigeria 2004.
[535] (2010) 2 NWLR (part 1179) 530.

3. Since the intention of the email messages and the correspondence from the Respondent, the Solicitor and the Arbitrator to the Appellant was to achieve the result of communicating the fact that the arbitration proceedings had been initiated at various stages of the process, there has been effective service of the whole arbitration process on the Appellant.[536]

Since potential disputes are likely due to increased foreign investment activity, Nigeria could become an attractive destination for international arbitration.

3.6. GENERAL EVALUATION OF THE PARTICIPATION AGREEMENT

In evaluating these arrangements, a number of points may be made. State participation of itself will not guarantee Nigeria control of its petroleum industry nor assure enjoyment of the utmost benefits from the industry. The objective of Nigerian participation is not merely to maximise financial returns whilst remaining a dominant partner in the industry. To a certain extent, the government seeks, through the NNPC, to be an active partner in the petroleum exploitation, retaining control of the nation's petroleum resources and assuring future development for maximum eventual benefits. Principally, however participation agreements are perceived by host countries as a medium to exercise control over the exploitation of their hydrocarbons, the truth of the matter is that participation or equity ownership does not mean control for these countries. In practice, it only helps to augment the political image of the host government, for the real management remains with the major oil companies, because the host country is deficient in technical know-how and management skills to effectively protect the government's interest. Notwithstanding the majority equity position of the host country in the joint venture, the effectual powers are in the hands of the major oil companies.

By dint of the fact that they are the operators, they are in charge of exploration, maintenance, programmes, and supplies of equipment, the employment of expertise and all operational matters. Although the NNPC has a built-in majority on all the boards of the joint venture companies, since all proposals originate from the operator, it goes without saying that the latter's representatives will have foreknowledge of such proposals and willingly approve of them.[537] Additionally, it is conceivable that they may tailor their proposals to their own advantage. Since the

[536] (2013) 4 NWLR (part 1343) 67.
[537] Gidado (n 392) 152.

Nigerian representatives do not have the same foreknowledge of the operational management of the joint venture and sufficient knowledge in oil matters, there is a strong likelihood that they may go on to endorse it without having fully grasped its repercussions.[538]

The fundamental truth is that leaving all technical and economic matters to the operators makes it impossible for the NNPC to develop the necessary skills for the operation of the venture. Consequently, with the agreements limiting Nigeria's involvement in managerial tasks to those excluding operational matters, the accomplishment of independent operational capacity is frustrated.[539] In respect of a similar subject, it has been commented: "that unless the host country has the skill and expertise, the control is rather political".[540]

Commentators have favoured the view that by concluding joint participation agreements, a host country will boost its revenue earning situation. This theory is founded on the premise that under participation agreements, the host government can receive, in addition to tax and royalties and the like, dividends proportionate to its interest in the venture.[541] For instance, if the government has a 60 per cent equity interest in the operations, it takes an equivalent dividend, while at the same time receiving the normal tax plus any dues payable under its fiscal laws. Nonetheless, it has been argued that this may not always be the case because, for instance, a 50 per cent dividend may not bring more revenue than 50 per cent tax.[542] It has been further observed that that all costs and expenses, including interests on loans, debts and investment funds, are deducted before dividends are paid, but not before tax.[543]

Consequently, a Government that has contributed its share of investment and other obligatory payments, can suffer a considerable loss in the instance where the joint venture company does not make any profit at the closing stages. On the other hand, if it is a viable undertaking, it will be more appropriate for the government to actively participate than to just be a spectator and wait for returns to be made to it periodically. The latter would invariably mean putting new wine into an old bottle;

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538 *Ibid.*
539 *Ibid.*
540 S Mankabody, 'Oil Contracts in the Middle East, (1980) 1(1) International Contract Law and Finance Review 119.
541 Gidado (n 392) 153.
542 *Ibid.*
543 G K N Ogunlami, 'An Analysis of Nigerian Petroleum Profits Taxation' (1989) Centre for Petroleum and Mineral Law Studies.

going back to the concession regime with all the attendant consequences of that policy. The upshot of this argument is that profit sharing or additional oil revenue is definitely less important than other objectives of state participation. These were well defined by the one-time advisers to the ruler of Abu Dhabi when he noted that:

> *"The participation we propose is not intended to be a mere device to secure additional revenues to the states concerned. It goes further than that. The first result would be to give the governments, through their national oil companies, a voice in the policy decisions of the company and to exercise more control over their oil industry. Governments should no longer be satisfied with the role of a 'sleeping partner' or 'absentee landlord.' The second result is the long-term implication. Producing countries should develop technical and managerial skills in the oil industry in order to enable the governments to be in a strong position when the concession agreements begin to expire.*[544]*"*

Furthermore, according to Akinsanya,[545] in terms of achieving de facto control of the oil industry, equity participation did not represent a radical departure from the framework of the pre-1969 grants of oil rights. Even though the government nowadays has a majority representation on the boards of the subsidiaries of the transnational oil company, the honest truth is that de facto control still resides with the transnational oil company because they still maintain effective control of management of the subsidiary oil companies. The popular view is that in the absence of de facto control of the oil industry by Nigerians, it is doubtful whether equity participation is compatible with the principle of permanent sovereignty over natural resources.

The basic underlying principle is that de facto control entails the exercise of decision-making powers in such vital operational and managerial matters as budget, expansion and development programmes, and appointment of top management, pricing, marketing, declaration of dividends, borrowing, reorganisation, procurement of equipment, in addition to the incorporation of the enterprise with the

[544] 'Disparity of Concession Terms in Middle East Oil Producing Countries' (1968) Middle East Economic Survey 9 (emphasis added).
[545] Adeoye Akinsanya, 'International Protection of Direct Foreign Investments in the Third World' (1987) 36 International and Comparative Law Review 58.

developmental intent of the government.[546] Therefore, the proper test of the feasibility of any new arrangement with the alleged objective of vesting control in the government is whether it will result in de facto control being vested in a board of directors in which the government has a majority representation and, as a result, the power to make the vital decisions on these specific matters and additionally to dictate provisions which will make the acquisition of all relevant know-how as regards operational management by Nigerians mandatory. Notwithstanding the government's acquisition of majority equity shares in the subsidiaries of the transnational and its majority representation on the boards of these companies, the governments have been willing to delegate the management of the subsidiaries to the transnational companies, apparently postulating that they can exercise de facto control solely through representation at board level.

According to this argument, the official segregation of duties between the board and the management is such that the board is sometimes downgraded to nothing more than a rubber-stamping role as far as vital management issues are concerned. The end result of such an arrangement is that the benefit of managerial power which the transnational company had before the introduction of equity participation remains to all intents and purposes nearly intact.[547]

The corporate structure of the transnational companies helps to promote their control of Nigeria's oil industry. Consequently, even though all foreign oil companies operating in Nigeria must be registered in Nigeria as local companies, the management may still continue to refer all major decisions, whether technical, managerial or financial, to their parent companies in America or Europe[548] as the case may be. The effect is that the headquarters of the parent companies hold on to de facto control under the new arrangement, in which they are technically junior partners.[549]

An additional concern arises from the existing structures. The government's pursuit of ownership and control of the oil industry may have led to a misunderstanding between symbols and substance. The fact is that careful examination of the key management positions of the transnational companies operating in Nigeria shows that

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[546] Asante (n 4) 346.
[547] *Ibid.*
[548] *Ibid.*
[549] *Ibid.*

Nigeria has not developed the potential to manage the oil industry[550] and as a result, their decisions naturally reflect the views of the companies whose technical superiority is sufficient to overcome the consequences of Nigerian majority ownership and to keep in their own hands de facto control notwithstanding their minority position.[551] The honest truth is that de facto control, consequently, hardly ever matches up to the degree of equity ownership.[552]

It would thus appear erroneous to suppose that equity participation and the supervisory powers exercised on the boards of the subsidiaries of the transnational companies will be sufficient to ensure the exercise of de facto control of the oil industry.[553] It is doubtful whether de facto control can be successfully maintained in cases where management powers are limited to corporate planning in the short and medium term, however fundamental these two areas are.[554] The crux of the problem is that for management to be delegated with the day-to-day running of the oil industry, it needs to be able to deal with the highly complex standards of general direction and supervision, and that the government (even through the boards of directors of the subsidiary oil companies) being a new owner of the oil resources, have not been vouchsafed the opportunity to set up a record of corporate management in the oil industry.[555]

Additionally, Adeniji is of the view that, as in other petroleum exporting countries, Nigeria needs to see State participation in the day-to-day corporate management of the oil industry as a political as well as an economic necessity. Such participation should ultimately limit the presence of oil companies to a solely business role, whilst preserving government control for purposes of economic development.[556] It authorises Nigeria to veto proposed measures that are not in the interest of national

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[550] M S Olorunfemi, 'Managing Nigeria's Petroleum Resources' 24 OPEC 25-26.
[551] Adeniji (n 385) 175.
[552] Asante (n 4). see also Atsegbua (n 475) 103.
[553] Samuel K B Asante and A Stockmayer, 'The Evolution of Development Contracts: The Issue of Effective Control' in *Legal and Institutional Arrangements in Minerals Development: A study based on an International Workshop, West Berlin, 1980, jointly sponsored by UN Department of Technical Co-operation for Development, and the Development Policy Forum of the German Foundation for International Development* (London: Mining Journal Books 1982). See also Smith (n 345) 122 at 18.
[554] Asante and Stockmayer (n 553) 59.
[555] *Ibid* see also *The Petroleum Economics Monthly* (1976) XIII(7) 263.
[556] Adeniji (n 385) 161.

development. In this way, the companies would be transmuted into essentially managerial operating cadres in the framework of board government.[557]

It can safely be stated that de facto control has neither been advanced to any considerable degree through the sheer employment of equity participation substituting the traditional concession regime of the pre- 1969 grants of oil rights; nor has it, in fact, been exercised to the full extent predicted by the principle of permanent sovereignty over natural resources as canvassed globally. The basic fact is that de facto control of the oil industry can only be successfully exercised if "sufficient and appropriate capacity for control exists" i.e. control over management.[558]

According to Asante, transnational companies contend that the global character of their operations is intrinsically irreconcilable with the surrender of control to any of their affiliates scattered around the world.[559]As a result control by the host country is illusory. Some commentators have argued that adequate control is possible through exercise of regulatory power.[560]

Smith and Wells offer another view that:

> *"equity sharing or participation may or may not bring the government an effective voice in the management decisions within the operating company and may or may not mean that the government plays an important role in other activities leading to the ultimate development of the resources."*[561]

Participation can, of course, involve state participation. The determination of the level of local participation is naturally a matter for the host state. Nevertheless, questions will sometimes be posed as to whether strong local participation from the private sector is appropriate in a developing country where there might already be wide divergences of wealth. Such a policy might be of little advantage. The incomes thereby received might be invested or substantially spent outside the developing

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[557] *Ibid.*
[558] Asante (n 4) 350.
[559] *Ibid.*
[560] Jenkins (M.P.) in the debate in the House of Commons on the Petroleum and Submarine Pipelines Bill, 30 April 1975. Parliamentary Debate Official Report Fifth Section 1974-75 891 506-507.
[561] D N Smith, L T Wells, *Negotiating Third World Mineral Agreements,* (Cambridge: Ballinger Publications 1975) 573.

country, the local shareholders might identify themselves more with the foreign investors than with the interests of the host state, and most importantly, their equity interest might not be reflected in the control and management of the corporation.[562] Such a result could be achieved by the creation of different classes of shares whereby the local investors had little or no voting rights.

Thus, in Ghana, the Swiss firm Société Générale de Surveillance was engaged to verify the prices of exports and imports against the prevailing world market levels.[563]

Participation, then, must mean assuring effective participation in control and management; if this is not available locally, perhaps independent external expert consultants should be engaged until such expertise is available in the quantity demanded locally.

Also, another view is that in addition to royalty, income tax and any other payments which are to be made by the transnational company, the government should also be allowed a share in the net profits. For that reason, it was further observed that participation is "an ingenious way of further increasing the tax per barrel without touching either posted prices or nominal tax rates".[564] It does not necessarily follow, however, that this is the foremost objective which a government seeks to secure through participation. It has been argued that "government take" can be increased without resort to participation. The arguments advanced by them are that, to a certain extent, transnational oil companies prefer to yield a larger government take through increased taxes than through the mechanism of participation and that participation requires the creation of investments by government.[565]

3.7 THE MEMORANDUM OF UNDERSTANDING

The received wisdom is that when a transnational company, wearing its investor's cap, enters into a joint operating agreement with a country, it is well aware of the associated risk and will, as one would expect, seek to achieve a reasonable return on its investment. It is thus argued that it behoves the host country to provide appropriate incentives to compensate for that investment and associated risk.

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[562] David Flint, 'Foreign Investment and the New International Economic Order' in Kamal Hossain and Subrata Roy Chowdhury (eds) *Permanent Sovereignty Over Natural Resources in International Law: Principle and Practice* (1984) 168.
[563] Asante (n 4) 338.
[564] Petroleum and Submerged Pipe-line Act, 1975.
[565] M Adelman, 'Is the oil shortage real?' (1972) 9 Foreign Policy 84.

Consequently, Nigeria felt obligated to provide apposite incentives to oil companies and one such key incentive relates to improved fiscal terms aimed at ameliorating the effect of tax and royalty on the oil companies. The document which enshrines these improved fiscal terms is known as a Memorandum of Understanding (MOU).

Prior to the materialisation of the MOU in 1986, the only fiscal incentives were those contained in the Petroleum Profit Tax Act (PPTA)[566] 1959 and its subsequent modification. The PPTA provided for tax at 85 per cent on chargeable profits of companies engaged in petroleum operations, calculated on net profits after deducting fixed tax-allowable expenses. Exceptions were sometimes made where it was necessary to attract new entrants, and here the applicable rate could go as low as 65.7 per cent. Further, there was royalty payable to the host government at rates ranging from 16⅔ to 20 per cent, depending on water depth and terrain.[567] To counterbalance this, and on a comparable foundation, oil companies have the benefit of investment tax credit ranging from 5 to 20 per cent.

However, there was a drastic change in this situation in about 1976, when there was a steep decline in exploration and drilling activities; the profit margins capable of being earned by the operating companies were being gravely eroded through the high cost of operations and government take. The government responded to the companies' action by revising the notional fiscal margin and technical cost to $0.80/bbl and $1.00/bbl respectively in 1977. These incentives provisionally encouraged investment in exploration activities, and the industry observed improved exploration efforts.[568] Seismic data acquisition increased from the low of 8,000 km coverage in 1976 to 20,000 km in 1978. Total footage of exploration/ appraisal wells

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[566] Since its promulgation in 1959 (with a January 1, 1958 effective date) various legislative amendments have been introduced into the PPTA, the latest (which is of major significance) being the Deep Offshore and Inland Basin Production Sharing Contracts Act 1999, No. 30. Immediately prior to this, an amendment contained in 1999 No. 9 had been effected wherein it is *inter alia*, provided that the petroleum profits tax rate applicable to signatory companies of Production Sharing Contracts (PSCs) shall be 50 per cent flat rate of their chargeable profits for the duration of such PSCs. In other words, the PPTA is meant to apply to the taxation of the assessed incomes of companies which engage in petroleum operations. This includes companies engaged in liquefied and associated natural gas operations.

[567] Olayinka Alli, 'Joint Venture Investments and MOU Incentives: An Appraisal', in Victor Eromosele (ed) *Nigeria Petroleum Business, A Handbook* (Lagos: Advent Communications Limited 1997) 317.

[568] Seismic data acquisition increased from the low of 8,000 km coverage in 1976 to 20,000 km in 1978. Total footage of exploration/appraisal wells drilled during the same period also increased steadily until 1978, when it became obvious that the notional technical cost could no longer match the galloping prices of facilities and services within the oil sector. Again, the government increased the fiscal technical cost by 10% in 1978 to $1.10/bbl. Similar developments necessitated further adjustment of the notional margin and technical cost in 1982 and 1983.

drilled during the same period also enlarged progressively until 1978, when it became obvious that the notional technical cost could no longer equal the galloping prices of amenities and services within the petroleum sector. Once more, the government increased the fiscal technical cost by 10% in 1978 to $1.10/bbl. Comparable developments required further adjustments to the notional margin and technical cost in 1982 and 1983.

Surprisingly, however, between 1977 and 1983, the incentive packages were evaluated four times, signifying that the incentives never actually got to the root of the industry's economic problems. Even though in 1982 and 1983 there were dramatic increases in incentives, with notional profit margin doubled and notional technical cost up by 50 per cent, the effect of this, however, was short-lived. [569]

One of the foremost deficiencies in the way these four incentive packages were worked out was that they applied a non-market related price, the OSP (official selling price), in preference to a market-determined price. The OSP was generated by OPEC from time to time to reflect the oil price desired by the organisation at the time of issue.[570] The price was, to a large extent, independent of the market, and obviously inconsistent with the market realisable price, resulting in the OSP always being ahead of the market realisable price, every so often by as much as $5.00/bbl.

By the end of 1985, the price differential was so evident that the NNPC and the foreign oil companies found it almost impracticable to market their equity shares of the oil produced at OSP (official selling price), as required by OPEC. As a result, production began to dwindle and exploration operations nose-dived.[571]

At the centre of the oil surplus of the mid-eighties, Nigeria's official selling price (OSP) for crude oil became unrealisable in the market and as a result, the price of oil plunged to record lows, discouraging investment. As a result, the large fiscal burdens imposed on the operators led to reduced exploration, production and development activities in Nigeria. In most countries, this turmoil would have led to an amendment in the tax laws.[572]

[569] Alli (n 567) 320.
[570] *Ibid.*
[571] *Ibid.*
[572] Omorogbe (n 25) 87.

Furthermore, as world oil demands persisted, and non-OPEC production grew, the Organisation of Petroleum Exporting Countries (OPEC) plunged from its commanding height of controlling 80 per cent of the market in 1977 to 54 per cent in 1985. The Nigerian oil industry reacted by cutting back exploration expenditures, resulting in a net depletion of the country's reserve base. The oil companies' notional profit margin of $2/bbl which was already in place since 1983 apparently became unrealisable. This resulted in a significant reduction in oil production, leading, of course, to lost revenue to both country and company. The situation was further complicated by the method of fiscal accounting which was based mainly on a fiscal (or posted) price derived from the OPEC generated and non-market related Official Selling Price (OSP).

The government responded swiftly to this development to obviate further dwindling of oil revenues which contributed a large proportion of the nation's foreign exchange earnings by introducing an incentive package, better known in the Nigerian oil industry by the expression "MOU." The package was designed to stimulate investment in exploration and production activities and to encourage the export of Nigerian crude oil. This objective was achieved by abolishing the widening gap between the OSP and market-related price, thus guaranteeing a specific level of profit margin under a given technical cost. The MOU was first executed in 1986,[573] with a primary term of five years. It proved quite successful in reviving the pace of activities in the upstream sector, including crude oil lifting to a higher level.

The incentive took the form of a guaranteed minimum margin of profit to the companies in respect of each barrel of crude produced. The consequence of the memorandum of understanding (MOU) terms, where the terms and obligations were complied with, was that the company ended up paying less petroleum profits tax than it would have paid under the stringent provisions of the PPTA as at December 31, 1985. In consideration of the incentives, the company was obligated to carry out an agreed exploration work programme, the details of which constituted an Appendix to and part of the memorandum of understanding (MOU), as well as assisting in the lifting of certain volumes of the NNPC's equity crude during a period of glut. Failure on the company's part to meet its obligations would result in its profits being taxed under the PPTA provisions as at December 31, 1985. Certain details of the MOU were dealt with and particularised in Side Letters while matters that called for reviews

[573] Alli (n 567) 320.

were dealt with in the 1st and 2nd Amendments to the MOU about 22nd of October 1987 and 1st December 1987 respectively.

There was a second memorandum of understanding (MOU) implemented on January 1, 1991 with comparable objectives to those of the 1986 one but with an extended scope that incorporated Reserve Addition Bonuses in favour of the companies and a recompense for cost efficient operations. The Reserve Addition Bonus (RAB), according to Clause 2.9 of the subject MOU, was to be set-off against the company's PPT legal responsibility in the affected year, to the extent that in that year, the trappings to oil and condensate revitalisation surpassed the production for that year, as approved by DPR.[574] However, in 2000, the RAB entitlement provision was obliterated from the MOU and as a result, the RAB policy came to an end.[575] In consideration of the incentive embodied in the memorandum, the oil companies had embarked on increasing their work programme. The companies also agreed to lift certain volumes of NNPC's crude oil which the NNPC was unable to dispose of and in return to share the profit margin equally with NNPC.[576]

On August 4, 2000, a similar MOU was signed for a life of three years. The fundamental objectives were essentially to provide incentives for boosting cost efficient exploration and development activities and also for the transnational companies' support in the realisation of the country's long-term growth objectives in the petroleum sector, which were also part and parcel of this MOU. Particularly noteworthy in the taxation area is that the MOU contains a complicated formula for calculating what goes to the Government in a fiscal year or accounting period, etc.

The underlying principle of the current MOU can nevertheless be stated in a nutshell. According to the information obtainable, what goes to the Government and is passed on in the MOU as "Government Take" consists of both royalty and petroleum profits

[574] The Department of Petroleum Resources (DPR). The DPR is headed by a Director General who is responsible for the setting of standards for the effective control of the petroleum industry. The DPR's general responsibilities and objectives are:

1. Ensuring compliance with petroleum laws and regulations through monitoring of the operations of the exploration companies.
2. Ensuring the full development of Nigerian petroleum resources
3. Ensuring the protection of all oil and gas investments (foreign, local, public and private).

The DPR processes all applications for licences from all entities seeking to carry out business in the oil and gas sectors. In so doing, it regulates and certifies by way of guidelines, the prerequisites for all registration requirements and/or bid submissions in the sector on behalf of the Ministry of Petroleum Resources (MPR)

[575] Etikerentse (n 384) 266.

[576] M Fatayi-Williams (ed), *The Nigerian Oil Industry* (Lagos: Nigerian National Petroleum Corporation 1994) 7.

tax relating to a joint venture company's operation in respect of an accounting period.[577] The MOU makes it fiscally desirable for the oil company to put its affairs in order so that its profits can come within the more favourable ambit of the MOU as against the PPTA's rigid provisions. As a result, most joint venture companies prefer to have the taxation of their profits subject to the terms and conditions of the MOU.

More so, in view of the fact that there exist very few precedents of commercial discoveries under the indigenous programme, instances of such concession are difficult to identify. In addition, because the process is discretionary, there is no assurance that the related tax concessions will be uniform or similar to the MOU terms for all indigenous operators, nor is there any form of assurance that any tax related concession will be granted.[578]The basic truth is that if such tax-related concessions are granted, they can possibly be enforceable by the courts.

However, attention has been drawn to a difficulty which arises concerning the taxation laws which appertain to the country of origin of the transnational oil company when the oil company claims to have paid its tax based on the MOU terms (being a contractual arrangement) rather than under a fiscal statute such as the PPTA. It may be argued that, technically, the payments made under the terms of the MOU are contractual payments, and that as such, they cannot be classified as tax, with the result that the local branch of the transnational oil company has not, strictly speaking, paid tax. The resolution of this question is a significant matter, because under the laws of certain countries, for instance the United States, credit can only be accorded for taxes paid by a multinational corporate entity if such taxes had been levied and paid in accordance with the existing fiscal laws of the countries where the tax-paying subsidiary of the transnational company operates, and not as provided under an ad hoc arrangement. Until the validity or otherwise of the MOU mode of payment is clarified by a court of competent jurisdiction in Nigeria, the issue will remain doubtful for the time being.

In exploring a possible answer to this difficulty, and in trying to approximate what the court's attitude might be, recourse may be made to examining the Court's opinion in a related matter. This was the view that was canvassed by the Supreme

[577] See the December 31, 1995 Royalty and PPTA provisions as amended, calculated by the substitution of Posted Price with Official Selling Price and the revised "Government Take" according to the December 31, 1985 Royalty and PPTA provisions (as amended) calculated by the substitution of Posted Price with Tax Reference Price.
[578] Akinrele (n 430) 314.

Court in the case of *Shell Petroleum Dev. Co. vs. FBIR* (1996)[579] when the Court came to the conclusion that:

> *"There is no doubt that the agreements…are not illegal contracts because their terms vary the obligations of the appellant and the respondent under the Petroleum Profits Tax Act…nor are they against public policy. Similarly, in Solanke v. Abed,[580] since the agreements are not illegal it follows that the principles of contract can rightly apply to them."*

It was suggested further that because the Nigerian Government and the oil companies have carried out their business in this way since the implementation of the first MOU on January 1, 1986, and the oil companies, paying their taxes to the Government in accordance with the MOU terms and the Government accepting and not demanding payment under the strict PPTA provisions over the years, the Government would be debarred from refuting that the oil companies had fulfilled their tax payment obligations. Also, it can be successfully argued that the legal doctrine of 'accord and satisfaction' may possibly put a stop to either party disagreeing with the success of the payments made under the MOU terms.[581]

The memorandum of understanding (MOU) provides an overall structure for allocating oil income amongst the joint venture (JV) partners, including payment of taxes and royalties as well as the industry profit margin. The 1991 Revised Memorandum of Understanding was predicated on the objectives of achieving a national hydrocarbon reserve base of 25 billion barrels (from 20 Billion barrels) while keeping production at 2.5m barrels per day by 1997. In the year 2010, it is anticipated that the Nigeria oil production hopes to increase to four million barrels per day.

The view is that even though a good number, if not all, copies of participation agreements examined are mute on what rates of taxation, fees, royalties and other levies are payable by the co-venturers to the government, such provisions as relate to these licences and leases under the Petroleum Act 1969 which pertain to fiscal measures will apply to these agreements, with the exception only of such provisions

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[579] *Shell Petroleum Dev. Co. vs. FBIR* [1996] 8 NWLF part (466), p. 285.
[580] *Solanke v. Abed* [1962] SLNR 371 1ALL NLR 230 at 233-4.
[581] Etikerentse (n 384) 267.

as have been varied by a memorandum of understanding (MOU). The joint ventures, i.e., between NNPC and its partners, are therefore, liable to pay royalty, taxation and other chargeable fees as presented for the oil prospecting licences OPL and oil mining leases (OML) holders.

The Petroleum Profits Tax Act (PPTA), therefore, provides the formal basis for taxation of the Joint Venture companies. However, taxation is also strongly governed by the memorandum of understanding (MOU), which together with royalties creates the fiscal arrangement with the Joint Venture companies. The PPT/MOU system covers over 95% of Nigeria's current oil production and will cover a substantial percentage of future production (when undeveloped reserves are brought into production).

The other matter that needs to be resolved is that if the MOU is proposed to be renewed by Government, it is proposed that it be codified into law to provide for greater legal lucidity specifically in regard to tax administration and avoid conflicts that it has with the Petroleum Profits Tax Act (PPTA). This is due to the MOU requiring two tax calculations to be made. The taxpayer is allowed to choose the lower of the two tax calculations in order to be guaranteed a certain after-tax margin based on crude oil price levels and operating cost and capital expenditure levels. This creates conflicts and confusion since it is not in consonance with the law. The first tax calculation is based on PPT and Royalty without any adjustment while the second calculation (referred to as Revised Government Take or RGT) is based on the MOU. The formulae used for this second calculation of RGT are rather complicated.

Also, observers are of the view that Codification must also provide for the indefatigably changing conditions in the worldwide oil and gas industry, thus preserving the flexibility of response to economic and an oil market situation which is contained in the MOU and which provides for episodic amendment.

It has been commented that the MOU negotiation process is an extremely technical undertaking, which requires a profound knowledge of the industry, internationally and also in Nigeria, as well as extensive financial expertise. In addition to adjustments for inflation, the focal points for negotiation are technical cost (TC), notional margin (M) and realisable prices (PR). Collaboration on these three vital points, as well as other MOU provisions, must be handled by professional oil and gas industry specialists under the management of the Minister of Petroleum Resources. Regrettably, no substantive Minister of Petroleum has been appointed. This Study recognises the current deficiency in expertise within FIRS[582] as of today and suggests, in the short-term, the utilisation of independent consultants, under whose management, FIRS specialists would be trained.

Also provided for in the revised MOU is the Reserve Addition Bonus. An oil company becomes entitled to the bonus if in any one year its addition to the ultimate reserves of oil and condensate exceeds the production for that year. The bonus is enjoyed in the form of an offset against petroleum profit tax liability for the given year. The modalities for calculating the Reserve Addition Bonus are set out in the Memorandum of Understanding.

In consideration of the incentives contained in the memorandum, the oil companies undertook to increase their work programme. The companies also undertook to lift certain volumes of NNPC's crude oil which the NNPC was unable to dispose of, and in return share the profit equally with the NNPC. In addition, another instance is where the company was unable to lift all or part of the crude oil that it was obligated to lift; the company had to pay to NNPC a penalty of 2% of the "average realisable price" for each barrel of crude oil that it failed to lift. The penalty payment did not apply if:

- The unlifted volume for each calendar quarter less than 5 per cent of the volume which the company was required to lift during the relevant calendar quarters.
- The unlifted volume was lifted within 15 days from the beginning of the following calendar quarter or in the event of force majeure.

The notional margin has been eroded by a number of compulsory payments in the form of indirect taxes such as Value Added Tax, education levy and levies by maritime authorities. As a result of the indirect taxes and increased technical costs, the oil companies demanded that the MOU should be renewed.[583]

The positive impact of the MOU of 1991 was reported in the following terms:

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[582] Federal Inland Revenue Service: they are merely consultants charged with the responsibility of collecting taxes. It also aims at correcting and clarifying any ambiguity that may have been created in the course of performing their duties as enshrined in the tax statues.
[583] Olisa (n 380) 195.

"The favourable response to these incentives…led to the addition of 1.5 billion barrels of to reserves in 1992, as against a planned target of 1.1 billion barrels, thus bringing the total crude oil reserves of the nation to 20.5 billion by 1994."[584]

Then followed the very important statement that:

"The policy of flexible and competitive fiscal regime…which has proved useful will continue to be pursued."[585]

It may be inferred from this that the MOU will continue to be in force, subject to periodic revision, of course.

3.8 THE WIDER VIEW

In order for Nigeria to compete successfully in the international energy market, it must adopt the right approach to tackle fundamental industry-specific matters. These matters include: reforming the national energy policy, instituting a modern fiscal and legal framework, harmonising OPEC's quota, designing funding investment polices, developing commercial outlets for gas, and finally, establishing and monitoring environmental protection.[586]

Currently, most multinational companies are not familiar with the provisions of the national energy policy, which exists in draft form. Therefore, it is important for the draft to be better publicised to target the multinationals, especially during this transitional period.[587]

There is a general consensus that existing fiscal and legal frameworks need to be modernised. Significantly, the necessary incentives encompassed in the MOU should be encouraged, especially in an environment of increasing cost per barrel due to the well-known "creaming" effect of the barrel and ageing fields.[588]

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[584] K S Chafe, 'The Problematic of African Democracy: Experiences from the Political Transition in Nigeria' (1994) 2 Africa Zamari 5. Indications are that Nigeria's crude oil reserves as at October 2002 were about 22 billion barrels.
[585] *Ibid.*
[586] Godwin Omene, 'Oil and Gas: Realising Nigeria's growth potential' in Victor E Eromosele, *Nigerian Petroleum Business: A Handbook* (Wit Pr/ Computational Mechanics 1999).
[587] *Ibid.*
[588] *Ibid.*

Furthermore, a long period has passed since Nigeria's OPEC quota was reviewed. However, it has become increasingly evident that in order to improve Nigeria's quota, the country will need to demonstrate that it has discovered more oil reserves and has a substantial production capacity. Therefore, this calls for significant investment in exploration and development.[589]

A further concern is the apparent funding difficulty currently being experienced by the oil industry, associated with the existing "cash call" mechanism; and as a result, many companies through the Oil Producers Trade Section (OPTS) have made various proposals as to how the industry could improve on its funding. Such proposals include, but are not restricted to, the following:

(i) Carry options
(ii) Cash call crude
(iii) Offset against petroleum profits tax (PPT)
(iv) Finance and servicing agreements etc.[590]

There is an urgent need to appraise these concerns and to take firm decisions.

In this age of greenhouse gases, there are now in place advanced environmental standards around the world and growing public awareness on environmental matters.[591] As a result, it has dawned on the oil industry in Nigeria that rethinking its age-old practices is vital. A classical case in point relates to gas flaring. It has become increasingly apparent that the flaring of associated gas not only represents an economic waste of Nigeria's dormant resource potential but that it is also harmful to the environment.[592] The World Bank estimates that "gas flaring in the Niger Delta releases some 35 million tonnes of carbon dioxide annually to the air." In view of the fact that carbon dioxide has been identified as a "greenhouse gas" and a contributor to global warming, major Nigerian oil companies are already committing resources to reducing or eliminating gas flares.[593] Age is beginning to take its toll on the Nigerian

[589] *Ibid.*
[590] *Ibid.*
[591] *Ibid.*
[592] *Ibid.*
[593] *Ibid*; For example, the SPDC initiative involves a commitment to install a US $1.6 billion complex of gas facilities around the Soku field in the East Niger Delta to process 450 million scf of gas of which some US $500 million will be allocated for environmental purposes. Also, for the Odidi field in the west which is an associated gas processing plant.

petroleum industry and a number of oil field and terminal facilities as well as flow lines need replacement or refurbishment.[594]

On the other hand, in recent years, oil companies have considerably increased investment in host communities in the areas of education and unemployment, health, agriculture and community infrastructure. It is now generally recognised that there is lack of development in the Niger Delta area. With the majority of the people in the area dependent on land for their livelihood, many oil companies have ensured that agricultural programmes are central to their community development efforts. Oil companies are in dialogue with communities, finding new ways to demonstrate their increased commitment to community development.

3.9 CONCLUSION

From the preceding it can be adduced that the different forms of acquisitions of oil rights divulge the fact that the act upholds the basic framework of the pre-1969 grants of oil rights. Petroleum joint ventures between the government or its National oil entity (the NNPC) and private investors from developed countries have increasingly taken over from the mere leasing or concession regime which appertained under the previous regime in which the control of petroleum operations was left in the hands of powerful international oil companies.[595]

Under the old-style concession regime in Nigeria, transnational oil companies were granted rights over vast areas for long periods, without any precise commitments relating to work or expenditure, in return for modest rents to the host country. The transnational companies knew a host country would no longer be prepared to grant rights over its hydrocarbons except in return for specific work and expenditure obligations which can be enumerated, appraised and supervised at each stage in the life of the project.[596] The rationale is that the host countries have become progressively more aware of the benefits to be obtained from the exploitation of their

[594] For instance, in 1996 alone, SPDC incurred a total environmental spending of US $314 million. This demonstrates that a large commitment is being made in that direction.
[595] International Oil Companies: Anglo-Persian (BP) in Iran, BP, Shell, Jersey Standard (and four American companies: Anglo-Persian (BP) in Iran, BP, Shell, Jersey Standard (and four American companies) in Iraq: Socal and Texaco in Saudi Arabia, BP and Gulf Kuwait, and Socal in Bahrain. These companies and Mobil, which later acquired an interest in Aramco, regarded as the seven major international companies and are referred to as 'the majors'. In Venezuela, the same companies (except BP) competed concessions, and ultimately by 1937, 52 per cent of the total output was held by Jersey Standard, 40 per cent by Shell, and 7 per cent by Gulf.
[596] Gidado (n 392) 151.

hydrocarbon resources and want to maximise the financial return to themselves for enhancement of their economic growth and development.[597]

There is a growing recognition amongst commentators that the most popular arrangement being sought and applied these days in developing countries is that of "participation", whereby the host country gains an amount of the equity within the operating company.[598] It might not give actual participation in transportation; it might not give participation in marketing. It may not even give the host country a real share in management and operations. In truth, it may simply give a host country a share of the income which the country might have had anyway under old profit-sharing arrangements. In particular, it is important to observe that even if the primary goal of participation is host government representation on the board of directors, in many situations that representation may be virtually meaningless. As outside directors, government representatives often are unable to ask the right sort of questions within the board to put forward a rational government policy.

What is needed in addition to participation in this sort of situation is the acquisition by Nigeria of know-how, in the first instance through the assistance of a technical team of outside consultants briefed to inform, advise and teach the government's own or appointed directors about all aspects of running the oil and gas industries so that when they need to be able to make evaluations and judgments in the course of their participation on the boards of directors, these decisions can be made in Nigeria's best interests.

Furthermore, it is clear that the depletion trend which commenced in 1985 would have been very complicated to turn around without the introduction of an incentive such as MOU.[599] On the lifting of crude oil, this afforded the NNPC and the operators an immediate relief from the complexity of marketing their crude oil.[600] In particular, the NNPC benefited not only from being able to easily market its own crude oil, but also from the provisions of the MOU on notice/emergency volumes as a "back-up" tool for marketing its distressed oil cargoes.

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[597] *Ibid.*

[598] Thomas Walde, 'Revision of Transnational Investment Agreements in the Natural Resource Industries' (1978) 10 University Miami Inter-American Law Review 265.

[599] The MOU created a contractual package of incentives which guaranteed a minimum margin of profit per barrel of oil. The MOU terms when first offered were presented as an alternative to the BPT regime as it stood on the 31 December 1985; Quoted from Akinrele (n 430) 312.

[600] *Ibid.*

Even though the performance of the 1986 MOU has been remarkable, a few areas need modification to allow both parties (giver and receiver of incentives) to obtain optimal mutual benefits from the instrument.[601] The 1995 Budget suggests an evaluation of the MOU to simplify the computations which a number of users found cumbersome.[602] The oil companies are still in with the Nigerian government towards devising a revised MOU. There is copious evidence to suggest that in the course of execution, some operators have claimed the bonus in a manner not reflecting the original "spirit of the MOU." Further, the Production Cost Bonus is considered superfluous, as this is already treated as a deduction under the PPT Act 1959.[603]

It is fair to say that the Fiscalisation of the Realisable Price through the k-factor has been found to be excessively complex for many users.[604] Propositions have been made for the mechanism is replaced by a Tax Reference Price (TRP) mechanism, which simply computes fiscal price from the Realisable Price in the same way as the Posted Price was computed from Official Selling Price.[605]

The MOU has also encouraged investment in the development of new production facilities leading most importantly to new discoveries as well as to the refurbishing of old facilities. Nigeria has at least realised a sustainable production.[606] The problems of the mid-eighties which were linked with crude oil marketing and lifting can currently be consigned to times of yore.[607]

From the foregoing, the Nigerian version of Production Sharing Contracts ("PSCs") will form the topic of discussion in the next chapter. The PSC has turned out to be a well-known petroleum development system through wide-ranging national practice, as opposed to the concession system, and a substitute to other contractual arrangements.

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601 Alli (n 567) 325.
602 *Ibid.*
603 *Ibid.*
604 *Ibid.*
605 *Ibid.*
606 *Ibid.*
607 *Ibid.*

CHAPTER 4

EVOLUTION OF PRODUCTION SHARING CONTRACTS

4.1 HISTORICAL BACKGROUND

The Production Sharing Contract is deeply rooted in the Napoleonic Era and French legal concept of ownership of minerals, wherein mineral wealth is not to be owned by individuals but by the State for the benefit of all citizens.[608] This philosophy is embodied in the Article 33 of the 1945 Constitution of Indonesia, which states:

> *All-natural wealth on the land and in water is under the jurisdiction of the state and should be used for the benefit and the welfare of the people."*[609]

> *The PSC as a contractual form represents an accommodation of a spate of conflicting interests, a modus vivendi in the unending battle between a host country and foreign oil companies.*[610]

Out of dissatisfaction with the work contract, which was hardly an improvement over the concession agreement, there came into being another form of arrangement, namely the production sharing contract.

In the middle of the twentieth century, as colonial empires were crumbling, the corporations had to seek new means to defend their investments. In the case of the oil industry, the collapse of empires was followed by the setting of tougher terms by host governments, the renegotiations of existing agreements, and in most cases, nationalisation of assets. Production sharing contracts were first introduced in the 1960s, at a time when the European empires around the world were collapsing. They were seen by many as reflecting a new era of national control over resources, and a rejection of the colonial era concession agreements that had persisted for more than 50 years previously. But compared to the nationalisations that took place in most major oil-producing countries, the rise of production sharing contracts just a few years later readily seemed rather more appealing.

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[608] Daniel Johnston, *The International Petroleum Fiscal System and Production Sharing Contracts*. (Tulsa, Oklahoma: Pennwell Books 1994) 22.
[609] *Ibid.*
[610] *Ibid.*

Under this system, foreign participation were to be allowed only through the provision of a foreign loan. This principle was first used in primary production sectors, such as the timber and agricultural production industries. Foreign investors were guaranteed some return on their investment since there were no pre-production risks of loss, such as the exploration risks in the petroleum industry.

General Ibnu Sutowo, former founder and President-Director of Pertamina, incorporated this concept and instituted it in the petroleum industry in Indonesia.[611] In support of this system, he enunciated five basic principles that must be met for any future agreements with foreign companies.

1. The host country national enterprise would have management control;

2. The contract must be based on production sharing instead of profit sharing;

3. The foreign company would provide all the financing for the operation and to sustain the production risks which are recoverable out of 40 per cent of crude oil produced per annum. If the contractor's work expenses exceed 40%, the unrecovered excess may be recovered in the succeeding years. The contractor receives title to his share of the oil at the point of export;

4. The remainder of the production would be split 65/35 in favour of the government; and finally,

5. Title to equipment purchased by the contractor would pass to the State Enterprise upon entry into Indonesia.[612]

There is no commonly accepted definition for the PSC. From various studies, it seems that each writer shifts the emphasis over time depending upon the theoretical purpose of his/her study, nonetheless, these contracts have, in one way or the other, touched the nerve of the arrangement.[613] In Gao's words:

> *"The production sharing contract is an agreement under which a foreign company serving as a contractor to the host-country or its national oil*

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[611] Robert Fabrikant, 'Production Sharing Contracts in the Indonesian Petroleum Industry' (1975) 16 Harvard International Law Journal 303, 340.
[612] Anderson G Bartlett Robert J Barton, Calvin Bartlett, George A Fowler and Charles F Hays, *Pertamina. Indonesia National Oil* (1st edition, Amerisian 1972) 154-158.
[613] For information on other definitions of the PSC, see H R William and C J Meyers(eds), *Manual of Oil and Gas Terms* (8th edition, New York: Matthew Bender 1991) 973-74.

company, recovers its costs each year from production and is further entitled to receive a certain share of the remaining production as payment in kind for the exploration risks assumed and the development service performed if there is a commercial discovery.[614]

Independent Indonesia American Petroleum Company (IIAPCO) entered an agreement with Indonesia which was signed in 1966. It is generally argued that the IIAPCO contract of 1966 was the first genuine PSC in the petroleum industry.[615] The IIAPCO contract is important because it can be considered as a watershed in the evolution of Indonesia's as well as the world's petroleum agreements.[616]

It has been suggested that the concept of the production sharing contract originated in Bolivia or Venezuela as early as 1950.[617] Even so, one can safely argue that it was Indonesia that substantially modified the concept to the extent that the exportability of the concept became worldwide.

It is not new for investment agreements to give corporations extensive rights, prodigious profits and obligations to compensate for historical expenditure.[618] Where recently-negotiated investment, agreements differ from those in the past is in the extent of their enforceability and their dominance over international and municipal law.

Furthermore, the production sharing contract has a built-in tension between the desire by most countries to dominate and maintain control over their very important assets, and the need of the company to maximise the net present value of their investment. This expresses itself, on the part of the government, in a tendency to over-regulate, especially in areas of national sensitivity like the participation of nationals in the workforce in positions which range from labour through management and the enforced use of national products and services.

In this chapter, I will attempt to elucidate the following issues:

- What are production sharing contracts, in terms of their legal nature and their exportability?

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614 Gao (n 83) 68.
615 *Ibid.*
616 *Ibid*.
617 *Ibid.*
618 *Ibid.*

- How did they originate and what has been their subsequent development?
- How wide has the concept been extended geographically?
- What sort of variations exist in different countries?
- What are the desirable improvements to these contracts and how can they be implemented?
- How can government agreements be geared to protect the needs for sustainable development and protection of the environment?

4.2 DEVELOPMENT OF THE PRODUCTION SHARING CONTRACT

The idea of production sharing originated from the Government's attitude towards foreign investment during the early nationhood of Indonesia. During the post-colonial decade, the efforts of foreign petroleum companies continued to be hampered by nationalism and political turmoil. The Central Government had the herculean task of reconciling Indonesia's desire to control its natural resources with the need to generate foreign exchange through the development of these resources. Up till now, the concessionaires had therefore permitted to operate under let alone, or *Laissez faire*, agreements.[619] These agreements soon became the target of nationalistic censure in the Indonesian Legislature.[620] The transformation of the existing concession agreements into "contracts of work" relegated the foreign operators to the legal position of contractors to State Enterprises.[621] It was a reflection of the nationalistic policies favoured by the then government, which was not prepared to accept any foreign equity investment in Indonesia's economy.[622] As a corollary, foreign participation is to be allowed only through the provision of a foreign loan, which is to be repaid out of production.

The principle of production sharing was first used in the primary production sectors, such as the timber and agricultural production industries. Since then, it has become extremely popular and extensively used in several countries all over the world. The term "production sharing contracts" could possibly be reserved for arrangements whereby the foreign firm and the government share the output of the operation

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[619] Signed in 1948 with the Dutch colonial government; Alex Hunter, 'The Indonesian Oil Industry' in Bruce Glassburner (ed) *The Economy of Indonesia: Selected Readings* (Equinox Publishing 2007) 254, 259.
[620] *Ibid*.
[621] Alex Hunter, 'The Oil Industry: the 1963 Oil Agreements and After' (1965) Bull. Indon. Econ. Stud 16.
[622] Fabrikant (n 611) 309.

using a predetermined formula.[623] In practice, the term has been applied to almost any kind of arrangement whereby there is at least an option that the foreign firm and the government receive their benefits in kind rather than in cash. Most negotiators have worked their way through more than one epoch of the Indonesian model. [624] It will continue to function as a model for all others.

Under the standard PSC, the contractors bore the risk of exploration, so that if no commercial oil is discovered, the loss is borne by the contractor. In the event of a commercial discovery, the contractor is entitled to be reimbursed out of the percentage of the oil produced (referred to as cost oil) and further, by way of compensation for the work done by it, the contractor is entitled to the share in the remainder of the oil (referred to in the context as "profit oil")[625].

Initially, the percentage served for reimbursement of costs was 40 per cent in each year, until all costs were reimbursed.[626] Recent agreements, however, provide for a higher percentage in favour of the national company. The remainder is then shared between the contractors in predetermined proportions.[627]

Asante suggests that production sharing contracts between "most governments of developing countries and transnational corporations are essentially variants of service contracts, except in one important respect: they provide for sharing the production of the enterprise between the host government and the transnational corporation based on a prescribed distribution formula".[628]

One remarkable aspect of this kind of arrangement is that ownership of the petroleum discovered remained vested in the State or National Company and the Foreign Company, as the contractor, did not acquire title to its share of the crude oil until it reached the point of export and, in some cases, until the oil has reached a mutually agreed point.[629] Fabrikant contends that by postponing the title transfer, however, PSCs generate "an artificial distinction which acclaims form over substance, and that possibly the only significance in postponing the transfer of title is that it

[623] Ibid.
[624] Johnson (n 608) 71.
[625] Omorogbe (n 25) 60.
[626] *Ibid.*
[627] *Ibid.*
[628] Asante (n 4) 364.
[629] Omorogbe (n 25) 60.

might hamper legal action brought by contractors against the purchasers of nationalised oil".[630]

Furthermore, as in the case of service contracts, production sharing contracts varied considerably according to the particular natural resources and the circumstances surrounding their development. The purest examples of production agreements were the so-called Co-production Agreement that had been negotiated for manufacturing by western firms in the communist countries of Eastern Europe.[631] Typically, the western firms provided licences, machinery and technical assistance. In payment, they agreed to accept a certain amount of the product from the firm.

4.2.1 Management clause:

The conferment of management responsibility on the national petroleum agency is a marked departure from the management arrangement under the concessions, joint ventures and service contracts.[632] The big systemic issue, therefore, is whether the management framework under the production sharing contracts differs from the other arrangements and whether production sharing contracts proceed according to the wishes and aspirations of the parties concerned and the rules designed to preserve the primacy of the tenement of a production sharing contract. The production sharing contract is a fairly new legal format that is still evolving; the PSC was the outgrowth of the Indonesian national aspiration to regain control over its natural resources. With time, the demand for management was successfully incorporated into all PSCs and became a basic feature of the contract.[633] All PSCs provide at the outset that "the national company shall have and be responsible for the management of the operations contemplated under the contract" and the contractor is responsible to the State company for the execution of such operations.[634]

Not only was this clause seen as a masterpiece of ambiguity[635] when it was first introduced, but its very suggestion and eventual adaptation have been beset with a great deal of criticism. The foreign companies were interested in seeing their money

[630] Fabrikant (n 21) 139.
[631] *Ibid* 95.
[632] Fabrikant (n 611) 313.
[633] Gao (n 83) 80.
[634] *Ibid.*
[635] *Ibid.*

well spent and the Government of Indonesia, on the other hand, was interested in retaining unqualified management control. One problem was the vagueness of the clause which led the parties to fail to agree upon its interpretation. While the companies, on the one hand, wished to define the clause more clearly and make the clause implementable, the State national company deliberately tried to keep it vague and to retain it as a statement of principle[636]. Both parties contend that their rights should be respected: in the case of the companies, they contend that they cannot afford the separation of the investment function and its concomitant risks from the managerial functions of ensuring the proper utilisation of the capital invested.[637] The foreign companies were very apprehensive about the introduction of the management clause since it represented a radical departure from the contractual arrangements subsisting in other parts of the world. The majors[638] were unwilling to give up managerial prerogatives to inexperienced and not always friendly public servants and pointed to the inequity of separating managerial and capital risk-bearing functions.

Further, the majors contend that this clause would simply provide Indonesia with the legal means to conveniently eject the companies or nationalise them. An additional reason why the majors vehemently refused to accede to the management clause was that they feared it would precipitate the inclusion of similar clauses in their contracts with other oil exporting countries.[639] What is more, there was some apprehension that companies would be disqualified from receiving depletion allowance under United Nations income tax law.[640]

The controversy created by the management clause was effectively removed by the subsequent agreement to participation by a large number of the smaller "independents" that Indonesians saw as being more at amenable to the less

[636] Khong Cho Oon, *The Politics of Oil In Indonesia - Foreign Company-Host Government Relations* (LSE Monographs in International Studies, Cambridge University Press 1985) 116.
[637] Fabrikant (n 611) 315.
[638] The designation 'majors' customarily refers to the seven international companies: Standard Oil Company (New Jersey), Royal Dutch/Shell, British Petroleum, Gulf Oil Corporation, Texaco, Standard Oil company (California) and Mobil Oil Company. See E T Penrose, *The Large International Firm in Developing Countries* (George Allen and Unwin Ltd 1968).
[639]"Most Favoured Nation" clause confers upon the host country the right to adopt the terms of any other contract into which the company enters. Thus, the Major, by signing the PSCs, would have permitted any other host countries having most favoured nation status with which they had contractual relations to insert such a management clause in their agreement as well. See also Henry Cattan, *The Evolution of Oil Concessions in the Middle East and North Africa* (Dobbs Ferry, NY: Oceana Publications 1967) 99-100.
[640] Fabrikant (n 611) 315.

favourable financial terms.[641] Fabrikant states that "the prior acceptance of the management clause by the large number of independents would establish a precedent effectively foreclosing any kind of future agitation for the clause to be withdrawn".[642] A closer examination of the structure of the provision in a standard PSC and its actual working, however, reveals that the "the increased *de jure* authority has not necessarily affected the extent of *de facto* control over companies".[643]

The management programme under a PSC is so designed that work programmes in each phase of operations are drawn up by the contractor and submitted for approval by the national company.[644] In practice, the companies have submitted the rawest form of data. They raised objections to the submission of the evaluation reports on the grounds that they were already obliged to submit copies of original geological, geophysical and other data, and that the evaluation reports did not represent original data but were unoriginal in character.[645]A further objection was that the cost involved in preparing their reports was not included in the operating cost. This deliberately weak provision not only deprived the national company of evaluation reports but, in addition, by not specifying the kinds of statistics which the company should be required to collect and submit, it left the responsibility open-ended. With time, PSCs, and especially those adopted in other countries, have included express provisions for the submission of evaluation reports and some have purposely spelt out the significant kinds of statistics which the company should be required to submit to the host government.

4.2.2 Relinquishment provision:

A reduction/relinquishment provision is one which "requires the contractor to yield up to the host country part (in which case it is a reduction) or all (in which case it is a relinquishment) of some area (called the contract area) to which the production sharing agreement relates".[646] Such provisions vary from contract to contract. If, however, there has been a commercial discovery, the contractor is usually entitled to

[641] *Ibid;* The independents, because of their lack of capital and non-global operations, were anxious to enter into contractual relations with Indonesia. Moreover, many of these companies were not constrained by the "Most Favoured Nation clause".
[642] Fabrikant (n 611) 314.
[643] *Ibid.*
[644] *Ibid.*
[645] Hossain (n 259) 141.
[646] Gao (n 83) 75.

continue operations not only in the area where the discoveries have been made, but also in a substantial additional area. Some relinquishment is a standing requirement in PSCs, which provide for two types of surrender, namely mandatory and optional.[647] Under the mandatory exclusion provision, "the contractor must surrender an agreed percentage of the contract area after specified periods of time during the initial exploration period".[648] The PSC appears to leave the issues of the percentage of the contract area to be relinquished and the intervals at which relinquishment is to take place as matters to be negotiated, rather than being governed by a mandatory programme as in several other producing countries.[649] Consequently, the percentage of the area to be surrendered and the rate of recurrence of the relinquishments are items which the contractor may propose for negotiation and agreement with the national oil company (Pertamina).[650]

Typically, the "contractor is supposed to make three surrenders and to have relinquished 80 per cent of the original area by the end of the initial exploration period".[651] The PSC usually provides that the area retained after relinquishment shall not be in excess of 20 per cent of the original total contract area.[652] With regard to the area remaining after the mandatory surrender (roughly 20 per cent of the original contract area), the contractor is expected to "maintain a reasonable exploration effort".[653] If the contractor fails to submit an exploration program for such area during any two consecutive years, the PSC has two approaches to deal with such a state of affairs.[654] In the first method, the parties may seek to relinquish any portion of the remaining area or restart exploration. In the second method, the parties may decide that the area should be automatically surrendered.

With regards to the option surrender provisions, the contractor is given the right to surrender at the end of the second or third contract year and prior to the end of any subsequent year any portion of the contract area upon giving 30 days' written notice to Pertamina.[655] Such relinquishment can then be credited against whatever portion the contractor is next required to surrender. The PSC does not often have any

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647 *Ibid.*
648 *Ibid.*
649 *Ibid.*
650 *Ibid.*
651 *Ibid.*
652 *Ibid.*
653 *Ibid.*
654 *Ibid.*
655 *Ibid.*

precise arrangements or requirements as to the exclusion or retention of an area except for the broad proviso that with regard to the area retained, "so far as reasonable, such portion shall each be of adequate size and expedient shape to enable petroleum operations to be conducted thereon".[656] The whole contract area must be given back to Pertamina, if no discovery is made by the end of the exploration period.

Furthermore, whether a discovery is to be regarded as commercially significant so as to compel the contractor to undertake development under a standard PSC, is formulated in the following terms.[657]

4.2.3 Commerciality:

A significant characteristic of the modern petroleum contract is the commerciality clause, which is not an issue under the traditional concessionary contract. Under the commercial provision, "a discovery cannot be developed unless it is granted commercial status by the State oil company".[658] In other words, this clause marks the end of the exploration phase and the beginning of the development stage.[659] A burden rests on the contractor to prove whether or not a discovery is economically viable for both parties.

According to Gao, several oil companies have "complained about the negotiations associated with determining commerciality, and the issue can easily become an area of dispute between the contracting parties".[660] It deals with who determines whether or not a discovery is economically practicable and should be developed. According to Johnston, this is a "sensitive issue".[661] He goes on to explain that "one is often dealing with circumstances where accumulated exploration expenditures are so significant that by the time a discovery is made, these sunk costs upon development will flow through cost recovery (or will be used as deductions), and they can

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[656] Fabrikant (n 611) 331.
[657] Standard PSC form, reproduced in Anderson G Bartlett, Robert J Barton, Joe Calvin Bartlett, George Anderson Fowler Jr and Charles F Hays, *Pertamina: Indonesian National Oil* (Djakarta: Amerasian Ltd 1972) 337, 339.
[658] Gao (n 83) 80.
[659] *Ibid.*
[660] *Ibid.*
[661] Johnston (n 608) 64.

represent a considerable value, although they represent a liability, or a cost, as far as the government is concerned".[662]

Where the cost recovery is too great, the government may be left with only a small percentage of the gross production, depending upon the contractual/fiscal structure.[663] Some regimes will basically permit the contractor to make the decision as to whether or not to commence development operations. Other systems have a commercial prerequisite. This prerequisite fundamentally places the burden of proof on the contractor as to whether or not development of a discovery is inexpensively valuable for both the contractor and the government. Under countless commerciality clauses, a discovery cannot be developed unless it is granted commercial status. For instance, in Colombia, the matter of commerciality is convoluted by politics and instability of the succession of governments, so that there has been, on average, only a 50% carry-through from the exploration and delineation phase into actual development.[664]

Coming back to Indonesia, government participation begins at the point when commercial status is granted. If the government does not agree that the discovery can be developed, the contractor may still go forward. In that case, the government backs out. The matter, for the most part, is significant with progressive regimes where the government take is based more on profitability than on gross revenues.[665] If a marginal field is developed under a progressive regime, then the government share of revenues could be both small and substantially delayed. This creates "an important consideration that is significant in fiscal design. There is a trade-off. The systems with important limits on the contractor's access to gross revenues have little need for a commerciality requirement".[666]

Several problems may arise in relations between most governments and a company specifically when petroleum deposits are discovered in commercial quantities. The pertinent questions may include the manner in which commerciality is defined and

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[662] *Ibid.*
[663] *Ibid.*
[664] *Ibid* 65-66.
[665] *Ibid.*
[666] *Ibid.*

who has the power to define it; the procedure to follow after a commercial discovery; and the government option to participate in the development.[667]

Different situations may arise in which both the host country's government and the national oil company may consider that a discovery is not commercial and therefore oppose a declaration of commerciality.[668] In such cases, the aggrieved party is usually the private company. For this reason, the operating company will often wish to retain the determination of commerciality as its prerogative. It may also argue that commerciality is too vague a notion to define *a priori* in the petroleum agreement[669]. The usual practice is that the commerciality of a discovery will depend upon both market prices at the time of the discovery and the size of the discovery.[670]

The better approach will be that there should be a degree of flexibility, and in most cases, that will be valuable to both parties. For instance, the agreement may permit the host government to encourage the contractor to reconsider its stand.[671] But where the contractor determines that a discovery is marginal or non-commercial, the company may propose a modification to the contract.[672]

There are instances where different sets of circumstances may be found where, subsequent to a declaration of commerciality, the operator decides that the project is less attractive than originally envisaged. In such cases, the decision to develop may be changed. Notable examples are Norway, where the Ulla and Haemal fields were declared commercial, but development was subsequently delayed for several years.[673] By contrast, in the People's Republic of China (PRC) there is a general rule where the contractor is deemed automatically to have waived all its rights to a discovery if development does not commence within ninety days of the date of government approval for the development plan.[674]

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[667] Peter D Cameron, 'The Structure of Petroleum Agreements' in Beredjick N Walde, Thomas W Walde and Ian T Gault (eds), *Petroleum Investment Polices in Developing Countries* (London: Graham and Trotman Ltd 1988) 40.
[668] *Ibid.*
[669] Peter D Cameron, 'Government-company relations after the contract: reconciling objectives and strategies for long-term relations' in Kameel I F Khan (ed) *Petroleum Resources and Development: Economic, Legal and Policy Issues for Developing Countries* (London and New York: Belhaven Press 1987).
[670] Cameron (n 667) 40.
[671] *Ibid.*
[672] *Ibid.*
[673] Cameron (n 667) 40.
[674] *Ibid.*

Further, it is important to stress the fact that a successful well is not necessarily equivalent to a commercial discovery. Thus, a better view is that a successful well in a new area will probably depend on the results of a subsequent drilling.[675] In some extreme situations, the host country may argue that without at least some guideline definition of commerciality written into the agreement, they have little or no protection from the arbitrariness of the foreign investor.

In most petroleum agreements, at least some definition of commerciality is offered. But there are also instances where there is none, as in the case of Tanzania.[676] However, there are instances where the issue arose at a point in time when only a single discovery had been made and the one allowed was probably due to expire.[677] In such a case, the contractor would be obliged to surrender the entire area unless the discovery was classified as commercially significant. If, however, there was a commercial discovery, the contractor was entitled to retain not only the area where the discoveries had been made, but a substantial area in addition.

The systemic issue on the subject of time limits also often imposes a contractual limitation upon the host country's power. A time limit within which the host government must approve a commerciality application or lose the right of participation may very well be an attractive form of investor protection. There are different scenarios. In the first instance, the agreement may anticipate future problems by requiring the Minister or national oil company official to give approval within a specified period. For instance, in the case of Argentina, the period is 90 days. There are also instances where it might be stipulated that failure to extend such approval will indicate a presumption that an affirmative answer has been granted. On the other hand, however, the need to request explicit approval from the host government on this matter might function as a disincentive.[678]

4.2.4 Drawing Up a Development Plan:

The next question is what procedure is to be followed in the event of a commercial discovery. Once a discovery is classified as being commercially significant, the area in respect of the commercial discovery is usually set aside from the remainder of the

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[675] *Ibid.*
[676] *Ibid* 16.
[677] *Ibid* 16.
[678] *Ibid.*

area covered by the agreement and is designated a 'development area'.[679] Before the commencement of the project, the host government normally requires the foreign oil company to submit a development plan for official approval[680]. The investor is usually obliged to submit its development plan because the development phrase involves extensive obligations on part of the contracting party.[681] The host country, in addition, has a duty to ensure that environmental safety and social interests have been considered before development actually commences. A more concise development plan can be found in the Danish Government's Model Joint Operating Agreement (1986). A proposed development plan should include:

1. *A description of the hydrocarbon deposit(s) to be produced, with detailed analyses and evaluations of geological conditions, technical aspects of the reservoir and production and economic factors.*

2. *A production plan with particulars concerning the date for commencement of production and the anticipated magnitude of the annual production for each year the deposit is planned to be in production. If it encompasses more than one deposit, such particulars shall be given for each deposit covered by the plan as well as for the cumulative production anticipated under the plan.*

3. *A general description of the facilities planned to be installed including the number and type of wells, and equipment for production/reinjection, measurement, storage and processing, and pipelines between individual porting systems planned for the hydrocarbon produced.*

4. *A risk analysis for the planned facilities with a statement of measures to be taken to reduce identified risks.*

5. *A plan for the development project is to be carried out, including a time schedule, economics, and organisational plan for the execution of the project.*

6. *A detailed description of any element of uncertainty in the project with respect to reserves, time schedule, economics and so on, together with all other data,*

[679] Cameron (n 667) 40.
[680] *Ibid* 41.
[681] *Ibid* 41.

studies, interpretations, maps, models, and so on, which may be necessary for an evaluation of the project.[682]

For the efficacy of the development plan, the host government and the private company will have an interest in the prompt approval of the development plan.[683] In this case, a balance of equilibrium must be reached with regards speed and careful consideration of the information submitted.[684] As a matter of practice, the development plan should be approved before development commences.[685] It is important to do so, since it will provide the oil company the assurance that the proposed investment will meet the required criteria acceptable to both parties, permitting changes to be made without unnecessary waste or expense.[686] In addition, it should be expressly provided that there should be a contractual requirement that recovery occurs in accordance with prudent economic and technical principles so that waste of petroleum is avoided.[687]

Furthermore, there are also instances where the host government may require the international oil company to prepare a joint development plant to exploit petroleum on a cooperative basis.[688] Further, where dispute arises between parties, such disputes could be settled through arbitration or by reference to a third-party expert.[689]

4.2.5 Marketing of the crude oil:

Generally, PSCs require the contractor to bear marketing responsibility for all crude oil produced in the contract area, including the State's share of the crude oil. Besides giving prior notice to the contactor, however, the State or National Oil Company can take its portion of the oil in kind.[690] Quite a few contracts nonetheless contain provisions reducing the total quantity of oil which the contractor is obligated to market on behalf of the national oil company.[691] According to Fabrikant, "this ceiling is ordinarily expressed through a formula, which in effect requires the contractor to

[682] *Ibid.*
[683] *Ibid.*
[684] *Ibid.*
[685] *Ibid.*
[686] *Ibid.*
[687] *Ibid.*
[688] *Ibid.*
[689] *Ibid.*
[690] Fabrikant (n 611) 317.
[691] *Ibid.*

market a quantity of national company share which equals almost twice its domestic supply requirements".[692] Under the PSCs, several provisions are incorporated which are designed to make the contractor's operation serve domestic economic development.

Initially, under a production sharing contract, domestic supply was not included but with time this provision became a common feature in all PSCs.[693] Since 1966, a uniform provision compelling oil companies emerged to fulfil certain obligations towards the supply of the domestic market in Indonesia, the so-called domestic obligation[694]. Usually, in a typical a production sharing contract, the contractor undertakes to market all the crude oil produced in the contract area.[695] In a number of contracts, the marketing obligation of the contractor is reduced and restricted to a quantity to be determined by a formula. Suffice to say that the quantity each company supplies varies according to its own production volume and decreases as overall oil production increases[696].

4.2.6 Pricing:

The valuation of the petroleum is crucial in determining the amount of royalty and tax receivable by the host country. Historically, crude oil prices have been based either on realisation (the actual sales price realised or the posted price set by the host country and which, as a rule, is higher than the realised price).[697] Currently, many countries prefer to set the price of crude oil at an approximate weighted average of international crude oil prices, allowing for transportation and quality differentials (e.g. Peru, Norway and Indonesia).[698] Whatever basis is used, petroleum prices should be based on true third-party country sales, (e.g. Brazil and Guatemala).[699]

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[692] *Ibid.*

[693] *Ibid* 318.

[694] See Sec. V, art 1.2(p) of the model individual PSC. The documents used in making this observation include, but are not limited to the following (1) the 1976 model PSC, (2) Production Sharing Contracts of 12 February 1979 between Pertamina and Indonesia Petroleum Corp., in *Barrows Company (Asia Contracts) Asia and Australia: Basic Oil Laws and Concession Contracts*, supp 2 (New York: Petroleum Legislation Co 2001).

[695] Fabrikant (n 611) 318.

[696] So long as the pro rata quality does not exceed 25 per cent of total production from the contract area. For instance, in the 1970s, Pertamina took about 19.2 per cent of the output.

[697] Fabrikant (n 611) 318.

[698] Fabrikant (n 611) 318-319.

[699] *Ibid.*

In the case of Indonesia, the issue of pricing is important, since the determination of price has a major impact on the profits and the government's revenue. For instance, the Indonesian PSC uses an "export price".[700] The figure had been introduced for cost recovery and tax calculation purposes. Traditionally, this price has usually been the government-set price which was to be in accordance with OPEC-type guide prices starting in 1988[701]. The official price at which the contractor is to sell has always been of huge concern.[702] The foreign oil company could make a large gross profit resulting from the actual difference between the selling price and the realised export price under a PSC where the government take consists of a share in the production.[703]

Prices nevertheless remain relevant under these contracts. Low prices increase the quantities of oil necessary for the contractor to recover operating costs, thus the total amount of oil available to Pertamina is consequently an important dimension. Low prices also lengthen the period of time necessary for the recovery of costs, thereby, postponing Pertamina's contractual right to a larger portion of production.[704]

Furthermore, there are also instances where the foreign oil company can influence the market by the prices at which it sells the cost oil and its share of profit, for if it sells them cheaply, this would tend to drive down the price at which the national company might be able to sell its share.[705]

It has been argued that in such situations, the national company in the case of Indonesia (Pertamina) needs to have built-in mechanisms to protect the State's interest in the issue of pricing.[706] In the case of Indonesia, there is an express clause which provides that if Pertamina is able to secure a higher price than the contractor for the "cost" oil, the foreign oil company must either match the price obtainable by Pertamina, or permit Pertamina to sell the oil on the contractor's behalf.[707] However, the effectiveness of this mechanism would be substantially reduced where a national company operating under a PSC did not have its own marketing apparatus or access

[700] *Ibid.*
[701] Art. 10 of Presidential Decree No. 467 of 1961. See also Art. 5(2) of the Decree of the President of the Republic of Indonesia No. 467 of 1961, in *Barrow Company (Asia Contracts)*, supp 8, 1966 Indonesia E2.
[702] Fabrikant (n 611) 318.
[703] *Ibid* 343.
[704] *Ibid* 345.
[705] *Ibid* 345.
[706] *Ibid* 345-6
[707] *Ibid* 345-6.

to marketing outlets, as would be true of many of the national companies in developing countries.[708]

Secondly, there are instances where valuation of cost oil sold to affiliates was to be done on the basis of a weighted average per barrel net realised price obtained in arm's length sales of independent third parties, or in sales affected by Pertamina in exercise of its right to sell where it could obtain a price higher than the contractor.[709] It was expressly provided that:

> *"The value of such sales to Associated companies (affiliates) should be determined in a commercial manner, taking into account prices at which comparable types and quantities have been sold in competing export markets, bearing in mind, in that connection, possible differences in quality and in export costs."*[710]

Thirdly, there are also instances where there was an express provision prohibiting the contractor from giving any discount, commission or brokerage fees to their affiliates, while requiring that any commission or brokerage fees paid in connection with sales to third parties should not exceed the customary and prevailing rate.[711] This prohibition is self-executing, but its efficacy depends largely upon Pertamina's ability to identify affiliates' transactions.[712]

In addition, there also other forms of safeguard in place with regards to financial matters, as provided by virtue of the power vested in the national oil company to approve the budgets and to undertake auditing and accounting of the operations.[713] Smith and Wells position, however, is that if deductions are applied to the "amount of income accruing to the government in the calculation of these operating costs incurred by the company under post-1965 agreements, such deductions must be given the quality of scrutiny that would be given by a government tax office to deductions from gross income in a traditional concession agreement."[714]

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[708] *Ibid* 345.
[709] *Ibid* 346.
[710] Standard PSC form (n 663) 352.
[711] Fabrikant (n 611) 346.
[712] *Ibid.*
[713] *Ibid.*
[714] Smith and Wells (n 561) 587.

In most of the cases such scrutiny requires a high level of sophistication and expertise which is notably unavailable, in most cases, to Governments in some of the developing countries. For instance, in Norway, the view has been expressed that the governmental machinery was handicapped in monitoring the accounts, and in particular, the operating expenses of the companies.[715]

Arguably, a fundamental weakness in the standard PSC's financial provisions is that under them the contractor can earn substantial windfalls in the event of a rise in oil prices. According to Fabrikant:

> *"Although, price setting disputes between the parties are seen to be successfully avoided by the production sharing formula, the astronomical rise in price of crude oil pursuant to the Yom Kippur war reveals an inherent weakness of PSCs. As prices outstripped expectations, production sharing schemes received a windfall in unexpectedly high profits when the per barrel price of Indonesian oil was 5.05 in profit. As the price per barrel escalated to 51.00, the contractor profit increased to 52.75 per barrel."*[716]

4.2.7 Taxation matters:

Furthermore, other problems that greatly affected the US companies which have arisen in relation to the financial package as enshrined in PSC, are the result of a ruling given by the Internal Revenue Service of the United States, to the effect that a US company is not entitled to a foreign tax credit in respect of certain payments made by Pertamina to the Indonesian Treasury[717].

Similarly, the view that was canvassed in the matter in respect of a production sharing contract proposed to be entered into by Mobil with Pertamina under which Mobil would recover its operating costs in barrels of oil, but not to exceed an amount equal to 40 per cent of the value of the total number of barrels produced from the contract area during the said year.[718] The internal revenue in this matter, however, held that Pertamina's share of production was in substance, if not in form, a royalty

[715] Hossain (n 259) 347.
[716] Fabrikant (n 611) 346.
[717] Hossain (n 259) 347; Internal Revenue Service. Ruling, reproduced in petroleum legislation: Basic oil laws and concession contracts in Asia and Austral/Asia, Supp. 51.
[718] *Ibid.*

and that no part of such royalty was identifiable as an income tax or tax in lieu of income tax and therefore in this instance, Mobil could not be entitled to a foreign tax credit (under section GO1 and GO3 of the Internal Revenue code of 1943), nor to a deduction under section 164 in respect of any part of Pertamina's share of production applied towards payment of taxes to the Indonesian treasury.[719]

The Internal Revenue Service reiterated this position with regards to sharing ventures in the following terms:

> *"If a foreign government owns mineral resources and the taxpayer has an interest in such minerals in place, a foreign tax will not be recognised as a tax for U.S. Federal Income Tax purposes unless that government also requires payment that is commensurate with the value of the concession, such royalty or other consideration to be calculated separately and independently of the foreign tax. Satisfaction of such royalty by the U.S. taxpayer must be independent of any foreign tax liability".*[720]

In addition, "for foreign tax to be credited under section 901, it must qualify in substance and form as a U.S. tax under U.S. concepts".[721] According to Hossain, "in the absence of other factors which have contrary implications, payments to a foreign government owning the minerals in place extracted by the U.S. taxpayer will be treated as a creditable income tax if all of the following characteristics are present".[722] He explains further:

1. *The amount of income tax is calculated separately and independently of the amount of the royalty oil of any other tax or charge imposed by the foreign government.*

2. *Under the foreign income tax and in its actual administration, the income tax is imposed on the receipt of income by the taxpayer and such income is determined on the basis of arm's length amounts. Further, these receipts are actually realized in a manner consistent with U.S. income taxation principles.*

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[719] *Ibid.*
[720] Hossain (n 259) 347.
[721] *Ibid.*
[722] *Ibid.*

3. *The taxpayer's income tax liability cannot be discharged from property owned by the foreign government.*

4. *The foreign income tax liability cannot be discharged from property owned by the foreign country.*

5. *While the foreign tax base need not be identified or nearly identical to the U.S. tax base, the taxpayer, in computing the income subject to the foreign income tax, is allowed to deduct, without limitation, the significant expenses paid or incurred by the taxpayer. Reasonable limitations on the recovery of capital expenditure are acceptable.*[723]

Consequently, this ruling triggered considerable debate amongst interested parties and resulted in laudable reforms incorporated into the PSC, including the introduction of taxation.[724] The Ministry of Finance with further reference to this matter provided for two types of normal corporate income tax: the first being 45 per cent of taxable profit and the second being a dividend tax of 20 per cent on interest, dividends, and royalties after deducting the corporate tax.[725]

The introduction of taxation of foreign oil companies under a production sharing contract represents a substantial shift from the original arrangement and creates a form of ambiguity with regards to the government/company relationship.

In the participation clause under the production sharing contract, Pertamina has the right to demand that a 10 per cent undivided interest be offered to either a limited liability company or an Indonesian entity collectively called the Indonesian participant, that is designated by Pertamina.[726] This provision was incorporated in the 1976 form, and it was expressly provided that the option must be exercised within three (3) months of a commercial discovery.[727] The Indonesian participant under such circumstances assumes no exploration risks, since the participant is carried by the contractor during the exploration period.[728] Further, the Indonesian participant is required to repay the contractor a proportionate share of all past operation costs,

[723] *Ibid.*
[724] H F Russell, 'The Function of Tax Credit for the American Oil Contractor, Indonesia: An Allocation Approach' (1977) 10 Cornell International Law Journal 307.
[725] *Ibid.*
[726] See XVI art. 1 of the model and individual PSCs; See Hossain (n 259) 357.
[727] *Ibid.*
[728] *Ibid.*

including all matters which relate to information compensation and the production bonus incurred on his behalf.[729] Thus, there are ample of options open to such a participant, such as the reimbursement may be made at the participant's option either in cash or out of its production entitlement.

It is noteworthy that participation clauses in modern petroleum contracts bother most contractors[730] since they can be strong impediments to foreign investment. Very often, such a clause can become quite distasteful and can present management difficulties, because it can result in considerable erosion of the contractor's profits.[731] In Indonesia, the country infrequently exercises its option to participate and in cases where this option is exercised, the participation role is titular since the Indonesian participant holds only a minority interest in the joint venture.[732]

4.2.8 Employment and Preference for Local Suppliers:

A unique feature of all PSCs is that they all provide for obligations on the part of the contractor to "prepare and carry out plans and programs for industrial training and education of host countries' nationals for all job classifications with respect to operations."[733] Secondly, the contractors also agree to employ qualified Indonesian personnel in their operations and after commercial operations commence and in addition will train and educate the Indonesian personnel for labour and staff positions.[734] Under the PSC's specific provisions requiring the contractor to give preference, in its cost of operations, to the use of goods and services produced in Indonesia or rendered by Indonesian nationals, provided such goods and services are offered at substantially good conditions with regard to quality, price, availability at the time and in the quantities required, the cost of such training and activities to be treated as part of "operating costs". [735]

Furthermore, since 1988, many changes have taken place in the Indonesian oil industry. It can be argued that under the new procedures, production sharing contractors purchase equipment subject only to a post-audit inspection.[736] It is worth

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729 *Ibid.*
730 Gao (n 83) 92.
731 *Ibid.*
732 *Ibid.*
733 *Ibid* Sec. V Art. 1.2
734 *Ibid.*
735 *Ibid*; See also Sec V Art. 1.2(r) of the model and individual PSCs (n 657).
736 *Ibid.*

noting that goods and services that are available on the local market still need prior approval. Notwithstanding, contractors in the exploration stage remain free to purchase their equipment wherever they choose.

It has also been argued that procurement procedures are intentionally now being simplified and further simplification will be made in line with the government's "deregulation policy".[737] In practice, however, the PSC contractors should not make so much ado about Indonesia's preferential requirement to use domestic goods, because the truth of the matter is that no sophisticated exploration equipment is made locally. Until such time as the know-how is available for such equipment to be made locally, the requirement is little more than a paper provision with no actual substance.

4.2.9 Cost oil and cost recovery:

There are three essential elements in any production sharing agreement. When the venture reaches the production stage, the contractor will recover its allowable costs out of production. One laudable feature of the PSC is the cost recovery mechanism, which allows the contractor to recover all "operating costs" from production when a commercial discovery is made. This portion of crude oil that is used for the reimbursement of the operating costs of the operation is referred to as the "cost oil".[738] It has been argued that since the inception of cost oil provisions, contractors have only been able to recover their costs which were initially set at 40 per cent of annual gross production each year.[739] If, in any given year, the allowable operating costs exceeded this limit, the unrecovered excess was carried forward and recovered in succeeding years.[740] This generous provision mechanism under the PSC arrangement made it particularly attractive for the foreign oil companies, since they were able to recover their costs in fewer than five years.[741]

Cost recovery is an ancient concept. Even communists are comfortable with it. The capital providers should at least get their money back. It is one of the most common features of a PSC. It is only slightly different from similar provisions which were in

[737] Gao (n 83) 95.
[738] Asante (n 4) 364.
[739] *Ibid.*
[740] *Ibid.*
[741] Tengku N Machmud (1993) 'Production Sharing Contracts in Indonesia: 25 Years' History' (1993) JENRL 181.

force under the concessionary system. Sometimes the hierarchy of cost oil can make a difference in cash flow calculations.[742] For the most part, this will be the case if certain cost recoverable items are taxable. The inherent vicissitudes resulted in the 1976 model PSC which introduced several strict terms. The new terms substantially revised the cost recovery procedure and the foreign firm's cost recovery was prolonged from seven (7) to fourteen (14) years.[743] In the period leading up to the 1976 PSC revisions, developments in the world market, starting with the 1973 oil crisis which caused oil prices to escalate drastically, caused the government to realise that a 65%:35% split allowed the companies far greater profits than had been foreseen in the 1960s.[744] Coupled with this was the fact that expectations at that time were that oil prices would continue to escalate and might reach US$50-US$60/bbl within the decade.[745] Consequently, these developments caused a change in the equity split was therefore negotiated, based on the principle that windfall profits caused by the escalation over the basis price of US$5/bbl were to be split 85/15 in favour of the government.[746] The foreign companies saw these new changes as devastating and due to their introduction, curtailed their exploration expenditure.[747]

4.2.10 FTP and investment credit:

The new or third generation contracts introduced further changes in the PSC. Cost recovery was rearranged with the introduction of the concept of FTP (First Tranche Petroleum) in the new package.[748] The FTP is a portion of production which is split between the government and the contractor before the deduction of cost recovery; as such it serves as a cap on the cost recovery.[749] Therefore, the contractor can recover its operating costs each year only from the remaining percentage of production after the deduction of FTP[750].

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[742] Samuel K Asante, 'Stability of Contractual Relations in the Transnational Investment Process' (1979) 28 International and Comparative Law Quarterly 401, 409.
[743] Anonymous, 'International Business: Oil and Gas (Indonesia) New Production Sharing Contracts with Foreign Oil Contractors', (1978) Recent Developments 19 Harvard International Law Journal 396.
[744] *Ibid.*
[745] *Ibid.*
[746] Machmud (n 741) 115.
[747] W Jenkens, 'Down to Business' (1977) Far East Economic Review 88.
[748] Machmud (n 741) 115.
[749] *Ibid.*
[750] Gao (n 83) 84.

Cost recovery/cost oil consists of "exploration and development costs, operating costs, current year, depreciation and amortisation, interest on financing, investment credit, and unrecovered costs carried over from previous years".[751]

In addition, there was a new provision on these contracts of "investment credit" which accompanied the abolition of the 40 per cent cost oil and was the worst feature of the new contracts.[752] These new developments met stiff resistance from the investing companies as they were perceived as slowing down recouping exploration and development investment and their intention was to facilitate the recovery of cost.[753] Investment credit is taken out of gross production before it is subject to taxation and it is also transferable to succeeding years until it is fully taken.[754]

It has been argued that the implications of the investment credit are twofold.[755] Firstly, this credit serves as an incentive for the investor to recover, through cost recovery, some substantial percentage of capital cost.[756] Secondly, the investment credit reduces the ultimate profit on the oil split for both the investor and the government.[757] In most respects, cost recovery is akin to the deductions in calculating taxable income under a concessionary system. The profit oil share taken by the government could be viewed as the first layer of taxation.

Nevertheless, the terminology is unambiguous and hearkens back to the ownership issue. A contractor under a PSC does not own the production and, as a result, at the point of cost recovery, has no taxable revenue against which to apply deductions. The government reimburses the contractor for cost through the cost recovery mechanism and then shares a portion of the remaining production or revenues with the contractor. Whilst cost recovery treatment is common in most PSCs, there are exceptions to the rule.[758] A number of contracts have no limit to cost recovery. Some PSCs have no cost recovery. The 1971 and 1978 Peruvian model contracts made no

[751] Smith and Wells (n 561) 70.
[752] Gao (n 83) 85.
[753] G Sacredoti, 'Indonesia Oil Hopes Revive' (1977) Far East Rev 43; see also Wall Street Journal (1977) 3.
[754] *Ibid.*
[755] Gao (n 83) 85.
[756] *Ibid.*
[757] *Ibid.*
[758] Hossain (n 260) 354.

allowance for cost recovery prior to the profit oil split.[759] The government basically granted the contractor a share of production which ranged from 40% to 50% depending upon the contract area.[760] An exception is where excess cost oil goes directly to the government. Even though this feature is quite rare, this provision was proposed by Egypt during the Nile licensing round in 1989.[761]

4.2.11 Compensation and Production Bonuses:

Generally, PSCs make allowance for a compensation bonus to be paid by the contractor after endorsement of the contract on receipt of the information concerning the acreage held by Pertamina which is to be made available to the contractor.[762] The amount of the compensation bonus varies considerably from one contract to another. Since the amount of the compensation bonus is a matter of tender and negotiation, it is frequently unconnected to the quality and quantity of the information held and offered by Pertamina. The payment for that reason is more in the nature of a "signature bonus" than a payment for information.[763]

The production bonus is a compulsory payment by the contractor once production reaches specified levels over a period of time, typically 120 consecutive days.[764] On the other hand, there is distinct pattern as to triggering the levels of production.[765] The number and the amount of the bonuses, which are a matter of bidding, differ from contract to contract, depending conceivably on the geological prospects and the acreage in question.[766]

Conceivably, bonus payments are borne exclusively by the contractor and cannot be built into the operating costs which are recoverable from production but can be charged against tax liabilities once profitable operation begins.[767] It is unrefuted that the rates of bonus payments differ considerably between individual PSCs, but there is no unambiguous reason to account for these differences.[768] Gao highlights that "one possible explanation is that the differences are related to the geological

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[759] *Ibid.*
[760] Johnston (n 608) 58.
[761] *Ibid.*
[762] Gao (n 83) 76.
[763] *Ibid.*
[764] *Ibid.*
[765] *Ibid.*
[766] *Ibid.*
[767] *Ibid.*
[768] *Ibid.*

attractiveness of the areas concerned. A high bonus payment can radically increase the chances of winning the contract, though other factors are also taken into consideration by Pertamina. The obligation for bonus payments has been deteriorating sharply in recent years".[769]

4.2.12 Production Split/Profit Oil:

In a standard PSC, the crude oil remaining after the deduction for costs is referred to as profit oil or equity oil, which is to be shared between the national oil company and the contractors in accordance with a predetermined ratio.[770] The usual practice is that this ratio is set by the national oil company in the draft contract. In order words, it is not subject to negotiation.

Over the years, substantial changes have occurred in the Indonesian petroleum sector. Under the second-generation PSCs, the profit split changed substantially, with an increase in Pertamina's share from 65 per cent to 85 per cent of production.[771] Such PSCs set a new tax split at 65.9091 for Pertamina and 34.0909 for contractors.[772] The remainder of production after taxation was split between the two parties as contained in the pre-tax split.[773]

In the third-generation PSCs, the profit oil share-out was restructured by the various incentive packages such as the ones embodied in the 1988 and 1993 PSCs.[774] Substantial changes were made, coupled with a government attempt to stimulate the development of its petroleum reserves in its eastern provinces, all of which fed into these third-generation agreements. The following issues were addressed. Firstly, the first tranche petroleum, set at 20 per cent of production, was to be split between Pertamina and the contractor, before the recovery of operating cost; this guaranteed Pertamina a minimum share of production, from the very start of production when costs still equal or exceed gross production proceeds.[775]

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[769] *Ibid.*
[770] Gao (n 83) 86.
[771] *Ibid.*
[772] Sec VI Art. 1.3 of the Model and Individual PSC, (1) The 1976 Model PSC, Draft Production Sharing Contract August 1976 (1976) Model PSC, (2) Production Sharing Contract of 12 February 1979 between Pertamina and at co Indonesian Petroleum Corp, in Barrow Company Asia Contracts, supp. 70, 1981, 50-93.
[773] *Ibid* 86
[774] *Ibid.*
[775] *Ibid.*

Secondly, an improvement was instituted in the contractor's share from tier areas of 25 per cent after tax up to 50,000bbl/day production and of 20 per cent up to 150,000bbl/day produced.[776]

Thirdly, there were improved incentives for new fields, such as unconditional investment credits and higher DMO (Domestic Market Obligation) from 0.20 to 10 per cent of export price.[777]

Lastly, deregulation in procurement of materials and services, which allowed more efficient operations. It is noteworthy that, since 1988, the production split has been relatively more flexible and diversified. The new equity split ratio, however, introduced only marginal additional incentives for deep water and frontier area development.[778] However, it is also noted that some terms and conditions such as the frontier and marginal field area incentives are not clearly spelt out.

4.2.13 Dispute Settlement:

Most PSCs specify that any dispute would be resolved not in the courts of the country concerned but in the International Centre for Settlement of Investment Disputes (ICSID) in Washington DC or the International Chamber of Commerce in Paris. All PSCs have a standard dispute settlement clause which employs a three-step procedure for resolution of disputes[779]. In the first place, both parties are expected to meet periodically and discuss the conduct of the petroleum operations and to make efforts to settle amicably any outstanding dispute.

The next step is arbitration; such disputes as cannot be settled amicably can be referred to arbitration.[780] These arbitration hearings are generally closed to other than the contract parties. Commentators have observed that in most cases, tribunals are presided over by arbitrators with a background as corporate lawyers, and therefore, narrowly favour commercial interest rather than broader issues of national interest or sovereignty.[781] It has been argued that "the system assigns the State the role of just another commercial partner, ensures that non-commercial partner issues will not be cured, and excludes representation and redress for populations affected

[776] *Ibid.*
[777] *Ibid.*
[778] *Ibid.*
[779] *Ibid* 93.
[780] *Ibid.*
[781] *Ibid.*

by the wide ranging powers granted (multinationals) under international contracts." [782]

The third stage of dispute resolution is judicial settlement; in the event the arbitration is unsuccessful, the dispute will be referred to the Indonesian Courts of Law.[783]

PSCs generally exempt foreign oil companies from any new laws that might affect their profits. Hiatt argues that such "contracts often stipulate that disputes are heard not in the country's own courts but in international investment tribunals which make their decisions on commercial grounds and do not consider the national interest or other national laws".[784]

4.2.14 Termination:

The contract cannot be terminated during the first few years from the effective date. There are three instances whereby the contract can be terminated.

First, "the contract can be terminated voluntary at any time should the contractor consider that circumstances do not warrant continuation of the petroleum operations. This is usually done by giving written notice and conferring with Pertamina". [785]

Second, during the exploration stage period, "if no petroleum is discovered, the contract will automatically terminate in its entirety, unless the contractor elects to extend it".[786] If petroleum is not discovered by the end of the extended period, some contracts require that the contract be automatically terminated.[787] Most contracts, however, grant the contractor the unqualified right to a further extension, usually for a duration equal to that of the prior extension period.[788]

Third, the contract could also be compulsorily terminated if a major substantial breach of the contract is committed by either of the parties or by either party upon

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[782] Susan Leubuscher, 'The Privatisation of Justice: International Commercial Arbitration and the Redefinition of the State' (2003) <http://www.fern.org/pubs/reports/disputer%resolution%20essay.pdf> accessed 6th December 2017.
[783] Gao (n 83) 86.
[784] Steve Hiatt, 'A Game as Old as Empire: The Secret World of Economic Hit Men and the Web of Global Corruption: Easyread Edition' (ReadHowYouWant.com 2009) 234.
[785] Gao (n 83) 93.
[786] *Ibid.*
[787] *Ibid*
[788] *Ibid;* Where it is normally granted, this period is usually for two years.

giving 90 days written notice.[789] This clause, however, is contingent upon conclusive evidence being proved by arbitration or final court decision.

Under this standard contract, the government could increase its share by increasing the rate of taxes payable by the contractor; but before signing these contracts, it appears, the companies had obtained undertakings from the government that tax rates would remain "frozen" and would not be wide-ranging during the length of the contract.[790]

The training obligations assumed by the contractor incorporated a precise obligation to provide $50,000 per year during the first 6 years, and $250,000 per year during the ensuing 10 years for scholarships and training of nationals in skills relating to the petroleum industry.[791]

4.3 THE ENVIRONMENT

Most PSCs, however, have shown little concern for the social and ecological impact of the extractive process. PSCs, both model and individual, do not have a separate article dealing with any environmental protection.[792] The environmental provision is not lawfully sound for a number of significant reasons. Foremost, its most important objective is apparently the "execution of the work programme", and environmental protection is given only a secondary place. Second, environmental obligations are not spelt out in operational terms.[793] For example, the phrase "extensive pollution" is quite unclear and open to a lot of interpretations. Seemingly, the contractor assumes no liability except if its operations have caused "widespread pollution".[794] Third, the provision fails to spell out the environmental objective to be achieved or to set out several significant requirements such as unambiguous preventive measures, clean-up and restoration operations, or insurance programs.[795] The words of the provision sound more like a policy suggestion than a legal obligation. As such, they are not

[789] Hossain (n 260) 125.
[790] *Ibid* 105.
[791] *Ibid.*
[792] Gao (n 83) 97.
[793] *Ibid.*
[794] *Ibid.*
[795] *Ibid.*

specific or strict enough to compel foreign companies to take their environmental duties seriously.[796]

Further, in PSCs generally national environmental legislation is not stated; the contract fails to refer production-sharing contractors openly to Indonesia's existing environmental guidelines.[797] According to Gao, "the loose environmental obligations may give rise to disagreement between the contracting parties".[798] Gao elucidates on the increasing controversy regarding who is responsible for the removal costs after a field is abandoned or decommissioned.[799] Over 300 installations located in Indonesian offshore waters, mostly in areas close to navigation routes were due for removal in the 1990s.[800] The financial obligations for maintenance and abandoning or decommissioning are substantial and burdensome for the contracting party that is responsible.[801]

PSCs have no specific provisions regarding the abandonment of offshore platforms. Pertamina has attempted, through negotiations with contractors, to have the maintenance and lighting costs included in the PSCs.[802] Legally however, once all equipment becomes the property of Pertamina once brought into the country, it is difficult to argue that the contractor has any responsibility to bear removal costs.[803] The subtle environmental provisions are possibly deliberate, because Indonesia must consider the degree to which the benefits from environmental protection exceed the costs incurred in the circumstance of a pressing need for foreign investment and economic development.[804] This also explains why these provisions have remained unimproved throughout contractual revisions in the past.[805] In short, the broad environmental terms of reference are essentially unenforceable because they contain no precise definitions and regulations.[806]

Also, the PSC system has smoothed the progress of exploitation of petroleum resources over the past few decades leading to increased economic development.

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[796] *Ibid* 98.
[797] *Ibid.*
[798] *Ibid.*
[799] *Ibid.*
[800] *Ibid.*
[801] *Ibid.*
[802] *Ibid.*
[803] *Ibid.*
[804] *Ibid.*
[805] *Ibid.*
[806] *Ibid.*

The colossal extraction has also created numerous problems, among them the diminution of petroleum resources. The declining of petroleum reserves has caused concern for many producing countries. Driven by the fear that existing fields will dry up within the foreseeable future, most State National companies have had to find new reserves and to into tap them swiftly to replace the older fields. For this and other reasons, the PSC is designed with strong encouragement for both the government and companies to optimise development and make the most of production in the event of a commercial discovery. As it stands, the contract contains practically no regulation for sustainable development.

Furthermore, Indonesia represents a great opportunity for the decommissioning of supply chain. However, there is often a lack of clarity on when and who should decommission assets. While developments are in motion, the investors have reiterated that current contracts only state that assets should be decommissioned at the end of life with no more information beyond this statement. Fortunately, with issues and regulations now being addressed there is a growing optimism that Indonesia could become the next big market for decommissioning.

4.4 EVALUATION OF PRODUCTION SHARING CONTRACTS

Production sharing contracts have been popular with the multinational oil companies. These companies control their own share of the petroleum products and except for an election by the national oil company to take its share in kind, they can control the destination of the State National oil company's share.[807] Most developing countries involved in the oil business have been driven by political and economic forces; they seek a contract structure that could assert sovereign rights over natural resources and meet the economic needs of developing the resources. Gao opines that "the PSC is a compromise between this political philosophy and economic reality".[808]

The PSC is an exceptional resource system pioneered, for the first time in history, by a developing country.[809] It fundamentally distinguishes the popular trends which were on the rise, predominantly prior to the mid-1980s, towards State control over natural resources by giving ownership and management to the producing host

[807] Gao (n 83) 99.
[808] *Ibid.*
[809] *Ibid.*

country.[810] The system also recognises the indispensable responsibility played by foreign companies in the activities of exploration, which are extremely risky and both capital and technology-intensive, by passing on the functioning rights to the latter.[811] It is also significant that the PSC gives both parties an equal right to receive a positive amount of production to meet their necessary goals, specifically, to have access to petroleum products.[812] This characteristic account, in part, for the rapid expansion of the system all over the world in the past several decades. [813]

It would appear that the PSC also places reliance on a mutuality of interests in the relationship.[814] In cooperation, both parties proclaim in the PSC their obligation to carry out the contract in agreement with the principles of mutual goodwill and good faith.[815] There is a growing recognition of the mutuality clause and a growing willingness to operate in response to it in diverse ways as a result. Certainly, one cannot deny the growth attained by the PSC over other arrangements which basically ignored the significance of this mutuality.

Significantly, the new structures have broken the tight link between ownership, control, and financial risks and benefits that was intrinsic in the traditional concession.[816] Smith explains that "arrangements have been negotiated which have repackaged these elements in ways that were not practicable under the old structures".[817] He further states that:

> *"because ownership and control have become significant political symbols in most developing countries, new contractual forms have been created to permit greater freedom in allocating ownership, control, and financial risks and benefits in ways that satisfy both the new political and economic imperatives. Ownership can be allocated in a way that makes the presence of the foreign firm politically acceptable in the host country. Increasingly, managers have recognised that financial benefits, their main objective, need not be completely linked with control. And*

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810 *Ibid.*
811 *Ibid* 101.
812 *Ibid.*
813 *Ibid.*
814 *Ibid.*
815 *Ibid.*
816 David N Smith, 'Mineral agreement in developing countries: Structures and substance' (1975) 69 American Journal of International Law 560, 589.
817 *Ibid.*

> *control need not be linked at all with ownership. The new forms of agreement will almost undoubtedly extend into a number of industries where they have not been common. In some cases, the new arrangements may not generate significant shifts in the allocation of financial benefits. In those industries where bargaining powers continue to shift in favour of the host country and where host country negotiating skills are satisfactory, changes will be more than political. There will be real changes in who controls operations and who receives financial benefits from the projects". Hitherto, whilst the new forms of agreement have provided ways of sharing symbolic power and economic benefits in ways that the traditional concession could not, they have not eliminated the complex technical problems relating to the allocation of financial benefits and financial risks. Thus, technical issues remain no matter what the structure of the agreement".*[818]

Without doubt, the concept of production sharing itself is an obvious acknowledgment and materialisation of the principle of mutuality of interests.[819] It is worth noting the contractual dynamism of the PSC; the system has undergone at least three key modifications since its commencement.[820] Every time the change is claimed to revolutionise and revitalise all PSCs, both existing and new. Notwithstanding all the fanfare, the modifications in terms were more the result of bilateral consultation and negotiation than independent action and force. It would appear that both the government and companies have at all times managed to find a way of advancing their negotiations so as to accommodate each other's objectives in a mutually satisfactory way.[821]

The PSC does not differentiate between onshore and offshore development, despite the fact that it was initially intended and used for offshore extractions.[822] Similar terms and conditions apply to both, exceptions being the investment credit and the positive equity split introduced by incentive packages in different years for oil and gas development in frontier and deep-water areas.[823] A number of the incentives introduced over the years are valid only to new PSCs signed after the proliferation of

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[818] *Ibid* 589-590.
[819] Gao (n 83) 101.
[820] *Ibid.*
[821] *Ibid.*
[822] *Ibid*.
[823] *Ibid* 102.

the incentive packages, whilst others are applicable to both existing and new contracts.[824] Thirdly, the modifications made in the PSC over the years have all served to decrease the clarity of the concept of production sharing as they have progressively made the production-sharing process more and more complex.[825]

On the negative side, PSC as a resource development system is definitely not perfect. Its most ineffectual features are possibly its management clauses. Officially, the duty of management is at all times vested in Pertamina in the case of Indonesia, and the contractor is in charge of carrying out the extraction.[826] In practice, however, Pertamina does not have adequate means to achieve the aim of full managerial control over all aspects of the operation and its authority to endorse company work programmes remains a rather token one.[827] In fact, it is the contractor who retains effective control regardless of the management clauses.[828]

Objectively, an assessment of the relationship between Pertamina and the foreign companies discloses the inconsistency between the "written word and the reality".[829] One can safely argue that too much or too little management has been achieved under PSCs. At the same time as Indonesia has claimed that oil exploitation in Indonesia is in the hands of Indonesians, others may argue that the management clauses only give the "appearance of domestic control".[830] In any case, despite the controversy over the management clauses, Pertamina's management capability has strengthened in recent times. As for the efficacy of the management clauses, it is justifiable to say that, under these provisions, the State maintains management responsibility, but the oil company exercises day-to-day control.[831] Largely, the legal inadequacy of the PSC, i.e., the gap between management control as outlined in theory within the PSC and as practised on the ground has also proven to be its strength, in view of the fact that it provides both parties with elasticity.

In the same vein as the management clauses, the provision for Indonesian ownership (Indonesianisation) is basically a token one owing to its formulation as a general obligation. To date, no clear-cut objectives have been set with regard to

[824] *Ibid.*
[825] *Ibid.*
[826] *Ibid.*
[827] *Ibid.*
[828] *Ibid.*
[829] Fabrikant (n 611) 337.
[830] *Ibid.*
[831] Gao (n 83) 102.

these obligations that could provide a benchmark against which any company's conformity with the government's objectives in this area could be measured. The vague nature of the contract provision has generated disagreement over definition, timing and enforcement.[832] What is more, the enjoyment of the whole of any price increase is seen, from the government's point of view, as the main weakness of the PSC.

In the field of employment, production-sharing contractors have found themselves essentially free to make use of and train their staff, irrespective of the contractual obligation of using the nationals of the host country.[833]

A further major area of concern that has remained with most PSCs is that, without doubt, their environmental provisions are mere window-dressing without any practical force. The system has, consciously or unconsciously, failed to address the issue in a proper manner. For a modern resource development system that can meet the environmental challenges of this century to be instituted in reality, the contract must rectify the current woolly approach by incorporating specific, attainable and valuable provisions for environmental protection and sustainable development.[834]

From the above discussion, it can safely be stated that there is no doubt the PSC will have contributed immensely to the government realising its objectives of maximising its revenue from the oil industry, but in terms of ultimately achieving *de facto* control of the oil industry and the development of the other aspects of petroleum operation, it has failed woefully. It is quite doubtful whether sufficient focussed thought and foresight has been given to the actual as opposed to the paper issue of transfer of control from the company to the government. The other matter is whether the PSC is compatible with the principle of permanent sovereignty over natural resources. The evolution of the oil agreement from the traditional concession regime to these newer forms of agreement has achieved financial and fiscal objectives for government but the fact remains that the issue of control and development of national interest has not fared well. According to El Chiati, labels, titles, appellations or headings given to

[832] Oon (n 636) 98.
[833] Gao (n 83) 102.
[834] *Ibid* 103.

contracts do not change their nature; only their contractual provisions and substance determine their nature.[835]

4.5 SUMMING UP

The attractiveness of the PSC amongst both producing countries and foreign companies stems from its admirable characteristics which have political relevance to governments and possibly also practical relevance to oil companies who have come to the realisation that they can no longer be noticeably in control of the petroleum resources of producing countries. The triumph of the PSC in developing countries is principally due to the political impetus to assert sovereign rights over national resources by producing an image of national control over petroleum development. The PSC represents a significant effort to equalise the historical imbalance between producing countries and foreign petroleum companies. Although PSCs exaggerate the actual shift in power between the parties, they provide an appearance of parity as well as a means for eventually attaining such equality.[836] One must look at the substance of each agreement to determine the bottom-line financial benefits as well as the controls that are involved in the particular contractual arrangement chosen.[837] Even though the new forms of agreement have provided ways of sharing symbolic power and economic benefits in ways that the traditional concession could not, they have not eliminated the complex technical issues relating to the allocation of financial benefits and financial risk. The technical issues remain no matter what the structure of the arrangement. [838]

The PSC has turned out to be a well-known petroleum development system through wide-ranging national practice, as opposed to the concession system, and a substitute to other contractual arrangements. Notwithstanding its key flaw on the environmental side, the system provides producing countries, on the one hand, with a reasonable foundation for petroleum development and foreign oil companies, on the other, with a stable environment for risky investments. It is not a hyperbole to

[835] A Z El Chiati, (1987) 'Protection of Investment Inherent in the Type of Agreement in A Z El Chiati, *Protection of Investment in the context of petroleum agreements* (Leiden: Martinus Nijhoff Collected Courses: Recueil des Cours 204 1987) 48-76.
[836] Fabrikant (n 611) 351.
[837] J Attwell, 'Changing Relationship Between Host Countries and International Petroleum Countries' (1979) Hous. L. Rev 1015.
[838] Smith and Wells (n 561) 590.

say that the PSC system is an important contribution made by Indonesia to the world petroleum industry.

From the aforementioned, the Nigeria version of the PSC will be elucidated in the next chapter. The main attractions are two major reliefs the PSC provides. First, there is the respite of the burden of cash calls, since all funding for the operations is advanced by the contractor and secondly, the relief of the burden of risk, since the contract becomes effective only after a commercial discovery has been made. For the investor and the contractor, however, the risk is considered worth taking because a commercial discovery would yield higher returns plus the additional relief that government interference is minimal in its operations. The PSC scheme was originally intended only for newcomers and small producers. This is because once a commercial discovery is made, the only essential risk is automatically removed, and participation becomes eternally profitable.

CHAPTER 5

NIGERIAN PRODUCTION SHARING CONTRACTS: PAST AND PRESENT.

5.1 INTRODUCTION

In Nigeria, in view of the burden of funding joint venture operations (cash calls) by the Nigeria National Petroleum Corporation (NNPC)[839] and the need to increase Nigerian oil reserves, the Federal Government decided to introduce the Production Sharing Contract (PSC). As in most developing oil exporting countries, the PSC is essentially a form of commercial transaction for the development of petroleum resources of the state which, as a sovereign owner of vital depletable resources, seeks to exercise its sovereign rights in the development of the resources by the foreign oil company. The basic principle underlying the PSC is that the oil company carries the whole cost of exploration within the geographical area stipulated by the contract and is rewarded accordingly if a commercial discovery is made and development follows. However, such rewards come in the following manner: first with an entitlement to extract oil from the discovered source up to the amount needed for recovery of its costs of exploration; following thereupon with a share in production revenues, which share is determined by agreement. In other words, the PSC contractor has full rights only to "cost oil" (i.e. oil to recoup production costs). It can have a share of "profit oil" (oil to guarantee a return on investment) after the company has defrayed tax and royalty obligations through tax oil on the license holder's behalf.

The Nigerian experience will form the subject matter of this chapter and the nature, purpose and terms as applicable to Nigerian oil sector contracts will be examined. Where appropriate, comparisons will be made with other jurisdictions with a view to ascertaining what such arrangement should provide for.

The further purpose of this chapter is to set out and examine the scope, the significance and the basic features of the typical PSC as it relates to Nigeria. As petroleum assumes

[839] The Department of Petroleum Resources is the regulatory arm of the Nigerian petroleum industry, charged with the overall responsibility for regulating, enforcing and monitoring the activities of the industry in accordance with the provisions of relevant laws. The Department used to be the Inspectorate Division of the NNPC established under section 10 of the NNPC Act before it was split off into an autonomous regulatory department.

increasing importance in the world economy, foreign oil companies are left with no choice but to compromise, in fact, many of the traditional prerogatives which they have previously enjoyed in the underdeveloped world. The PSC stands as an important effort to equalise the historic imbalance between the host country and the multinational corporation. Although such contracts seem to exaggerate the actual shift in power between the parties, they provide an appearance of equality as well as means for ultimately achieving such equality. How far this is true will be a further focus of this study. The new Production Sharing Contracts and the Deep Offshore and Inland Basin Production Sharing Contract will also be elucidated in this chapter.

5.2 PRODUCTION SHARING CONTRACTS

In Nigeria, the term Production Sharing Contract is defined in the Deep Offshore and Inland Basin Production Sharing Contracts Act, 1999[840] as:

> *"Any agreement or arrangement made between the corporation or the holder*[841] *and any other petroleum exploration and production company or companies for the purpose of exploration and production of oil in the deep offshore*[842] *and inland basins."*[843]

According to Ogiemwonyi[844] the PSC could be described as a "risk service contract where:

- Corporation appoints the contractor to carry out petroleum operations.
- Contractor provides necessary funds for petroleum operations
- Contractor is allowed to recover operating cost from crude oil discovered.
- Contractor bears the risk of operating cost, if no oil is discovered."[845]

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[840] Deep Offshore and Inland Basin Production Sharing Contracts Act, (1999) as amended. Federal Republic of Nigeria Official Gazette, No. 17, Vol.86, Lagos, 23rd March 1999. The law was enacted *inter alia* to give effect to certain incentives to the oil and gas companies operating in the Deep Offshore and Inland Basin areas under Production Sharing Contracts and such production sharing type arrangements between the Nigerian National Petroleum Corporation or other holders of oil prospecting licenses and various petroleum exploration and production companies concerning the terms Production Sharing Contracts.

[841] "Holder" means any Nigerian Company that holds an oil prospecting license or oil mining lease situated within the Deep Offshore and Inland Basin Under the relevant provision of the Petroleum Act, as amended. Section 18.

[842] "Deep offshore" means any water depth beyond 200 meters. Section 18.

[843] "Inland Basin" means any of the following Basins, namely, Anambra, Benin, Chad, Gongola, Sokoto and such other basins as may be determined, from time to time by the Minister. Section 18.

[844] CO Ogiemwonyi *The 1993 Production Sharing Contract (Undated).*

The Nigerian PSC differs in certain important respects from the Standard PSC, which was pioneered in Indonesia and which is the subject of the preceding chapter of this dissertation. The first Nigerian Production Sharing Contract was concluded in 1973 between the Nigerian National Petroleum Corporation (NNPC) and Ashland Oil (Nigeria) Company (then the Nigerian subsidiary of Marathon Oil Corporation) and initially covering the exploitation of the NNPC's concession in OPL 98 and 118 situate respectively in Imo State and off-shore Cross River State. The lifespan of the contract was stated to be twenty years from 1979 with a term of five years.[846]

This remained the only PSC in operation in Nigeria for over a decade until the end of the 1980s when, pursuant to the Government's oil sector policy in not increasing its joint venture exposure, and its encouragement of deep offshore exploration development, the PSC became the preferred vehicle of Government participation in the upstream petroleum industry. The deepwater acreages, which were allocated since the 1990/91 licensing round, have thus been based on PSC arrangements.

In 1992 and 1993, the Government, through the NNPC, negotiated new PSCs with Royal Dutch Shell, Exxon/Mobil, Chevron/Texaco, EniAgip, TotalFinalElf and the Statoil/BP alliance. These global parent companies were required to incorporate new Nigerian subsidiary companies to execute the PSCs. Addax Petroleum Development Company Limited subsequently acquired the interests of Ashland in the first PSCs in 1998 and this relationship is now governed by current PSC terms. Contractors who had existing traditional joint venture relationships with the NNPC were required to incorporate separate Nigerian companies to execute their PSC relationships. The reason for this was simply because it was important for the PSC operations to be ring-fenced from such companies' existing traditional joint venture operations. Therefore, the insistence by the NNPC during the negotiations leading to the PSC grants to Chevron and Shell, for example, on the incorporation of new separate companies resulting in the birth of Chevron (SNEPCO) respectively to operate their PSC awards is understandable. However, the provisions of the Nigerian agreement are less ambitious as compared to

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[845] *Ibid.*

[846] In 1991, the Minister of Petroleum Resources revoked the said contract on the grounds that Ashland Oil had sold its interests in four OPLs (Nos 96, 118, 90 and 225) to Perenco Investments SA (an American Company) without seeking the prior written consent of the Minister as required by law. See Daily Times Newspaper issue of Saturday, June 14, 1997.

those in Indonesia. Asante has argued that they are less pretentious than their counterpart Indonesian agreement in the areas of ownership and control.[847] Although the contract was signed on the 12th of June 1973, it did not come into effect until 1979 and it lasted for a period of twenty years.

5.3 RIGHTS AND OBLIGATIONS OF THE PARTIES

Under the NNPC/AON Production Sharing Contract, there are sets of obligations and rights which are included in the PSC. The most important of these are:

5.3.1 Operating Costs:

It is expressly provided under clause I that AON shall bear the risk of operating costs required in carrying out petroleum operations in the designated contract area. In other words, this clause imposes an obligation on AON to furnish the entire funding up-front for the costs involved in exploration, drilling, production and the day-to- day running of the PSC joint venture.[848] Secondly, AON is also required to provide the technical expertise for the performance of the work programme.[849]

The NNPC, on its part, is allowed to contribute professional staff to participate in the petroleum operations and is required to assist the contractor in obtaining necessary local funds, visa and work permits for its expatriate staff and in acquisition of surface rights. The cost incurred by the NNPC in rendering such assistance is reimbursable to the NNPC. Secondly, the NNPC also assures the contractor that it will not be discriminated against in any way and will be treated as well as any other oil companies operating in Nigeria. Further, the NNPC is also required to furnish Ashland with all geological data on drilling wells, production and other necessary information that they might deem necessary.

5.3.2 Ashland operating costs and the sharing of profit:

The Act defines the "operating cost" as expenditure made, and obligation incurred in carrying out any petroleum operation excluding, perhaps, the signature bonus if

[847] Asante (n 4) 366.
[848] Etikerentse (n 384) 42.
[849] *Ibid.*

payable. The term has been so defined because all allowable costs under the contract are recoverable from production if and when obtained. AON's costs incurred in the course of the operation, under this situation, if they are reimbursable, are usually dependent on whether the production of petroleum in commercial quantity will be sufficient to compensate AON for its operating costs.[850] The operating costs recoverable by Ashland out of the available oil is known as "cost oil." Under clause 6 of this PSC, Ashland is entitled to recover not only its operating costs but also interest costs on funds borrowed to conduct petroleum operations.[851] It is usually pegged at fifty per cent per annum of available crude oil. Under these circumstances, any unrecovered operating costs from the previous years are carried forward until fully recovered by Ashland in the succeeding years.[852]

Furthermore, after the allocation of "cost oil" at 40% of the total oil produced, out of the 60% remaining, 55% shall be allocated to tax oil and shall be applied by Ashland for the payment of petroleum profit tax payable after the production.[853] The balance of the available production after the deductions of cost oil and tax oil is known as the profit oil and would amount to 45% of the 60% remaining after deduction of the cost oil. The NNPC shall be entitled to receive 65% of this amount and Ashland shall be entitled to 35%. However, this was subject to the proviso that the NNPC share of profit oil was to increase to 70% of the profit oil upon the venture's operation reaching a daily production of fifty thousand barrels per day or more from the contract area.

Hossain argued that the cost recovery provision is particularly attractive to the international oil company since it enables them to receive a quick payout of fifty per cent of the oil towards reimbursement of exploration development and other operating costs they have incurred.[854] Each party under the contract is also at liberty to take in kind and dispose of available crude oil allocated to it. Thus, Ashland takes in kind cost oil and its share of available crude oil, as long as it finances the operation and conducts

[850] *Ibid*. Under clause 1(g), commercial quantity is defined as the capacity to produce at least 10,000 barrels per day of crude oil from the contract area.
[851] *Ibid.*
[852] *Ibid.*
[853] *Ibid.*
[854] Hossain (n 260) 148.

the same in accordance with the approved work programme and pays the applicable rent royalties and petroleum profit tax.

There are also instances where a host country might regard the 40% cost recovery as being excessive and commentators have argued this point. For example, Hossain explains with regards to the 1973 oil price escalation, that Indonesia sought an alteration in the contractual terms with the international oil companies, so that the existing cost recovery allowance that is usually forty per cent (40%) would be reduced to twenty five per cent (25%) and the ratio in which the remaining production would be shared between the government and the company would be changed from 60%/40% to 85%/15%.[855]

This new development did not go down well with the international oil companies, although the other legislative changes were more readily acquiesced to. The reaction was strongest in Indonesia, where the companies mounted a concerted opposition and as a result suspended any form of new exploration until the proposed amendment was substantially modified.[856]

5.3.3 Taxes:

In the earlier PSC negotiated in Indonesia, there were no provisions for the payment of income tax by the investor. This has changed, however, and such an international oil company is liable to a forty five per cent 45% tax on their income arising from the operations.[857]

Under the Ashland/NNPC PSC, petroleum profit tax of fifty five per cent (55%) is paid from the available crude oil after the deduction of Ashland cost oil. This is known as the tax oil. The "tax oil" consist of the tax payable by the NNPC and Ashland.[858] The price realised after the sale of tax oil shall be employed by Ashland towards the payment for the production.[859] Any additional amounts of petroleum profit tax due after the

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[855] *Ibid* 104.
[856] *Ibid.*
[857] Keith Blinn, Claus Duval, Honroe Le Leuch, and Andre Pertuzio, *International Petroleum; Exploration and Exploitation Agreements; Legal, Economic & Political Aspects* (London: Euromoney Publications & New York: Barrow Co Inc 1986) 77.
[858] *Ibid.*
[859] *Ibid.*

application of the fifty-five (55%) per cent for "tax oil" shall be paid by the NNPC and Ashland in proportion to the participating interest shares at the time that such additional amount of petroleum profit tax is payable.

It has been opined that for "administrative purposes, Ashland in practice also pays, on behalf of the NNPC, the taxes and royalties payable by the NNPC in respect of the NNPC's share of the joint venture production".[860] The last portion 'profit oil' is then shared between Ashland and the NNPC, in the ratio of 65 per cent to 35 per cent respectively; with a proviso that the NNPC's share is to increase to 70 per cent of the profit oil upon the venture's operation reaching a daily production of 50,000 or more.[861] Under the post-1992 PSCs, however profit oil is shared between the NNPC and the contractor at varying levels depending on the level of production; favouring the contractor at lower levels and gradually shifting in favour of the NNPC as production increases.[862]

In Libya, for instance, it is a different scenario. Under the Libyan PSC there is no provision for the payment of an income tax.[863] However, under this system, the National oil company retains a share of the production which is usually as high as 81% against 19% for the international oil company.[864]

It is immaterial whichever method is adopted, but what does matter is that the mechanism used depends largely on the host country's political and administrative convenience.

5.3.4 Management of the Operations:

It has been noted earlier in this volume that the management system in Indonesia in the early period of the application of this concept was a radical departure from the conventional arrangement in other parts of the world. In Nigeria, management is vested in Ashland while the Indonesian model reserved this exclusively for Pertamina. In this regard, the Indonesian production sharing contract goes further than other legal

860 Etikerentse (n 384) 89.
861 Article 9 of 1993 and 2000 PSC (n 663).
862 *Ibid.*
863 Blinn (n 857) 77.
864 *Ibid.*

arrangements in devising a mechanism for control, i.e. the designation of Pertamina as the manager of the enterprise. However, the effectiveness of this important provision is undermined in practice by Pertamina's lack of managerial and technological skills. Robert Fabricant views are remarkable:

> *"At first glance it is difficult [to argue] with Indonesian claims that, unlike typical concessionary arrangements, oil exploitation in Indonesia is in the hands of the Indonesians; yet an examination of existing relationships between Pertamina and the oil companies reveals the disparity between the written word and reality. The legal differences between production sharing contracts and concession contracts are often devoid of operational significance. In particular…contractors have retained effective management clause. The functions which Contractors have so far performed are virtually indistinguishable from those performed by concessionaires having formal equity interest and exclusive management prerogatives. The attraction, as well as the allocation, of capital, managerial skills and technology have remained basically in the hands of Contractors".*[865]

Whether or not undermined in practice, such a provision is notably absent in the NNPC/Ashland PSC where the ultimate responsibility for control and the management of petroleum operations is vested in Ashland. The fact remains also that such a management clause has never been enforced under most PSCs, since in most cases it is extremely difficult in practice to separate the overall management of operations from the day to day running of them, especially in cases where one of the parties involved bears the financial risks in the arrangement of operations. The absence of this vital provision in the NNPC/Ashland arrangement calls into question the government's objective of totally acquiring the overall control and running of the management of the industry. With regard to control, Gidado states that "the Ashland agreement departs from the Indonesian model in entrusting management and operational responsibility exclusively to Ashland".[866] It is feared that it will make it difficult to achieve the much sought-after control over natural resources and transfer of technology and it would have

[865] Fabrikant (n 611) 335.
[866] Gidado (n 392) 168.

been better if the agreement had provided for a transfer or proportionate sharing of management and operational positions as soon as commercial production begins; this would have provided an excellent watch-dog on Ashland's production and marketing activities.[867] Secondly, it would have also afforded NNPC's officials an excellent opportunity for learning the operational techniques and skills of the petroleum company.[868]

However, having regard to the cleavage between formal contractual provisions and practice in the Indonesian arrangements, the impact of the Indonesian provision is not noticeably different from that of the Ashland agreement.[869] The only significant difference is that by virtue of its formal management powers, Pertamina has more leverage in insisting on a close inspection of all aspects of the activities of the international oil company.[870]

The fact is that unlike the first PSC between the NNPC and Ashland, the current PSC includes provisions which allow for effective control and management by the NNPC in order to alleviate some of the deficiencies of the first PSC. For instance, the NNPC is responsible for the management of the operations while the contractor on the other hand is responsible for the work programme. To this end, management and control are undertaken through a committee comprised of ten persons who are appointed by the parties to the PSC; five by the Corporation (one of whom shall be the Chairman) and five by the Contractor.[871] However, the management committee function includes review of the work programme and ensuring that the Contractor implements the requisite accounting procedure.[872] It is expressly stipulated under this provision that approval of expenditure exceeding $100,000 and local purchases of $100,000 etc. must be obtained from the management committee before they are incurred.[873] This structure

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867 *Ibid.*
868 *Ibid.*
869 Asante (n 4) 335-362.
870 *Ibid.*
871 Akinrele (n 430) 164.
872 *Ibid.*
873 *Ibid*.

of management committee potentially gives the NNPC strong powers of oversight which, albeit in voting terms, do not numerically exceed those of the PSC contractor.[874]

Akinrele makes reference to the fact that "the NNPC's position is strengthened by the corporate rule in Nigeria that in the event of a deadlock, the Chairman of the NNPC will have the casting vote, since there is no specific provision written into PSC providing for a deadlock".[875] The truth is that these oversight provisions on accounting and expenditures are particularly important since they limit contractors' possible financial excesses and this provision has been further enhanced by the specific monetary limit placed in the 2000 PSC on cost oil recovery.[876]

5.3.5 Work programmes and expenditure:

The usual practice is for the work programmes to make detailed stipulations, expressed either in terms of minimum amounts that must be expended or sometimes in terms of technical details as to seismic surveys, exploratory wells, etc.[877] It is important to note here that either of these methods, if used alone, has its drawbacks. The truth is that the positive effect of minimum expenditure amounts may be eroded by inflation or unanticipated high costs. The situation is more complicated if the territory has never been explored previously and if it is consequently more difficult to state minimum exploration requirements. The solution might lie in work programmes that combine both methods, bearing in mind that the greater the geological knowledge about an area, the more effective the exploration, exploitation and production stages are likely to be.[878]

In the NNPC/Ashland PSC, under clause 4 of this arrangement, Ashland is mandated within three months after the effective date, subject however to any necessary extensions granted by the NNPC, to start seismic investigations in the contract area and thereafter to start drilling operations in accordance with good practice in the field.[879] Secondly, if geological conditions permit, Ashland is to commence drilling operations not

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874 *Ibid.*
875 *Ibid.*
876 *Ibid.*
877 *Ibid* 164.
878 Omorogbe (n 25).
879 NNPC/ Ashland PSC Clause 4. Quoted from Hossain (n 260) 141.

later than eighteen months after the effective date of the contract.[880] Furthermore, Ashland is also required by law within one month after the effective contract date, and thereafter two months before the beginning of each year, to prepare and submit for approval to the NNPC a work programme and budget for the contract area and such approval should not be unreasonably withheld.[881] However, when there is any revision to the work programme and the budget by the NNPC it is mandatory that such provision must be notified to Ashland within thirty days after receipt of the proposed work programme and budget.[882] If, for whatever reason, the NNPC fails to advise Ashland of any revision to the work programme and budget, it shall be deemed to have been approved.[883]

In the case of expenditure, clause 4 expressly provides that the amount to be spent by Ashland in conducting petroleum operations in the contract area during the first two years shall in the aggregate be not less than the equivalent of five million dollars.[884] Such amount to be prudently expended by Ashland with the concurrence of the NNPC.[885] Most times, it is extremely difficult for the NNPC to monitor the cost that is being incurred since, in all cases, the level of expenditure might be influenced by the adverse effect of inflation.[886]

5.3.6 Marketing of oil:

It was expressly provided in the PSC granting rights to Ashland that it may, on behalf of the joint venture, sell the quantity of the annual available production made up of.[887]

1. The cost oil

2. Ashland tax oil

3. NNPC tax oil

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880 *Ibid.*
881 *Ibid.*
882 *Ibid.*
883 *Ibid.*
884 *Ibid.*
885 *Ibid.*
886 Hossain (n 260) 141.
887 Etikerentse (n 384) 90.

4. Ashland participant's interest oil.

The marketable portions of the production were judged likely to be equivalent to between 77 per cent and 85 per cent of the entire annual available production.[888] The revenue earned by the Ashland was invariably less than the actual value of the crude oil Ashland was allowed to market because Ashland had the obligation to pay petroleum profit tax from the earnings derived from marketing the oil.[889] However, Ashland was expected to simply market the tax oil for both the NNPC and itself and to pay petroleum profit tax in respect thereof to the Nigerian government.[890] Etikerentse argued that "the PSC allowed Ashland to sell all or a portion of the oil to itself, but only at the price fixed by the NNPC. It is a standard practice that such price was usually at the NNPC's periodically announced applicable official selling price for various categories of Nigerian crude".[891]

Furthermore, the contract stipulates that that Ashland is obliged to market all or part of the NNPC's share of the available crude oil if the NNPC so notifies it in writing.[892] For the sale of the NNPC's share of the oil, Ashland receives a commission of one and one half per cent of the sale price f.o.b. at the port of export for the first 100,000 barrels per day.[893] Additional volumes attract commission of 1% of the sales price f.o.b. at the point of export. Ashland is required to instruct all payments due under the contract, less the contractor's commission to an account in any bank designated by the NNPC.[894]

Ashland is required at the end of each calendar year to furnish to auditors appointed by the NNPC all necessary information and also mandated to give them access to the books and records pertaining to crude oil sales made by the contractor of the NNPC's share of available crude oil during the year.[895]

888 *Ibid.*
889 *Ibid.*
890 *Ibid.*
891 *Ibid.*
892 *Ibid.*
893 *Ibid.*
894 P Eyinla and J Ukpo, *Nigeria. The Travesty of Oil and Gas Wealth* (Lagos: The Catholic Secretariat of Nigeria 2006).
895 Etikerentse (n 384) 90.

Etikerentse argues that the Ashland/NNPC relationship is beset with great shortcomings. For instance, he explains that the high rate of petroleum profit tax and the high level of cost oil allocation renders the oil split insignificant, leading to the three amendments which the subject PSC underwent between 1977 and 1992.[896] Further, in respect of operating cost and sharing of profits, it mandates that "cost oil" recoverable by investor shall be 30%,while "tax oil" is fixed at 40% and 30%, and the balance to be shared in the ratio of NNPC 35%, the investor at 65%.[897] However, the issues that arose then and the shortcomings in question have been addressed in the recent PSC.

5.3.7 Pricing:

The price of oil is material for the compilation of the government's share of profit and other dues. There are, however, different scenarios in this matter. For instance, if the price of oil in the world oil market drops, the realised price from the sale will also drop and the government's share from "profit oil" as well as taxes and other dues payable to the government will decrease.[898] Coupled with this, in those circumstances, there may be no incentive whatsoever on the part of the international oil company to carry out any further exploration activities.

Whenever the price obtained by Ashland, however, is more than the official selling price, it will invariably mean that the international Oil Company will have to pay more tax than would have been calculated as due because the computation of tax would not have been based on the actual market price but on the official selling price.[899] The additional tax has the adverse effect of reducing their profit margin and it was this ugly situation that led to the memorandum of understanding between the government and Ashland.[900] It is a fiscal device which is utilised in Nigeria. It was however, developed in the 1980s to cope with the problems caused as a result of the slump in oil prices and the large fiscal burden imposed on operators which invariably led to disinvestment in the petroleum sector.[901] In most countries this would have led to an amendment in the tax

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[896] *Ibid.*
[897] *Ibid.*
[898] Hossain (n 260) 117.
[899] *Ibid.*
[900] Etikerentse (n 384) 91.
[901] *Ibid.*

laws. However, in Nigeria the result was yet another agreement regulating the relationship between the government and the investors.[902]

5.3.8 Fiscal legislation:

Ashland has title to a substantial percentage of the crude oil produced. This provision was included in the Petroleum Profits Tax Acts.[903] By virtue of the PSC terms, the Petroleum Profits Tax and the Petroleum Drilling and Production Regulations[904] as amended, Ashland was obligated to pay tax and royalty in respect of its share of the oil produced. Strictly for administrative convenience, Ashland was required to pay on behalf of the NNPC the tax and Royalty payable by the NNPC in respect of the NNPC's share of the joint venture production. As regards to the fiscal regime, if the Ashland/NNPC agreement were evaluated on that basis it would appear that the NNPC/Ashland arrangements do not give Nigeria enough financial returns as compared to some other countries such as Indonesia, Libya, and Malaysia.[905] Furthermore, it is noteworthy that the Ashland/NNPC arrangement was notorious for the fact that the petroleum profit tax proportion was amongst the highest worldwide. In addition, the imposition of PPT on the contractor was unusual (most PSCs only attracted corporate tax), with the consequences that this PSC had the highest contractor tax liability worldwide at that time.[906]

5.3.9 Technology Transfer:

A transfer can be said to have taken place when technology developed and essentially applied by one organisation is utilized for production purposes and effectively applied by another organisation. In other words, without effective application no transfer can be said to have taken place. This effective application is possible only if the people in the recipient entity are substantially developed to be able to use the skills effectively, alone

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[902] *Ibid.*
[903] See section 8 of the Petroleum Profit Tax Act and the Act's interpretation section (section 2) for the definition of 'petroleum operation'. Ashland was thus obligated to pay petroleum profit tax at 85% rather than the lower company tax rate under the Companies Income Tax Act (cap 60).
[904] See statutory instrument No. 3 of 2001 and s 1. 6 of 2003, the latter regarding royalties for offshore and shallow offshore production sharing contracts effective 1 January 2000.
[905] Omorogbe (n 25) 89.
[906] S Adepetun, (1995) 'Production Sharing Contracts – The Nigerian Experience' (1995) 13 Journal of Energy and Natural Resources Law 23.

if they choose to do so.[907] Nevertheless the need exists for an effective and meaningful transfer of technology[908] if real development is to take place. In its absence the acquisition of technology would always be subject to the termination of the contract of acquisition.[909] It would appear that in speaking about technology transfer there is a certain amount of vagueness.[910] A transfer as such does not take place; it would however, be more appropriate to refer to the development of a local capacity to absorb ideas, skills and processes which are imported and to adopt them to local use.[911]

A definition of transfer has been offered:

> *"Transfer of petroleum technology should mean the ability of the developing country concerned to purchase or hire in the international market the most advanced equipment for the exploration and development at a fair and a reasonable cost. Above all it should also mean developing its human resources by enabling its citizens to acquire the mental capability and practical experience needed to comprehend the mysteries of modern technology and to manipulate the sophisticated tools."*[912]

At the same time the local base for the absorption of these ideas should be developed to the point where, with time, the total size of the imported package is reduced. An effective transfer requires that the country to reduce its dependence on imported technology with industrialisation.[913]

Under clause 5(i)(h), Ashland is expressly required in implementing the work programme, and in accordance with the clause, to prepare to carry out plans and adequate programmes for industrial training and the education of Nigerians for all job

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907 Omorogbe (n 25) 89.
908 Transfer of technology can be defined as the transfer of systematic knowledge for the manufacture of a product, for the application of a process, or for the rendering of a service. Transactions involving the mere sale of or mere lease of goods are specifically excluded. See Negotiations of a Code of Conduct on the Transfer of Technology. U.N. Doc. TD/Code TOT/17, March 3, 1981, 3.
909 K Khan, 'The transfer of Technology and Petroleum Development in Developing Countries: with particular references to Trinidad and Tobago' (1973) 4 Journal of Energy and Natural Resource Law 11.
910 *Ibid*.
911 *Ibid.*
912 H Zakariya, 'Transfer of Technology under Petroleum Development Contracts' (1982) 16 Journal of World Trade Law 207, 221.
913 Khan (n 909) 11.

classifications with respect to petroleum operations in accordance with the Petroleum Act 1969.[914]

Secondly, under clause 12, Ashland is also required within two months after the effective date and after consultation with the NNPC to submit a detailed programme for recruitment and within four months to submit a training programme for Nigerians in the carrying out of petroleum activities.[915] It is noteworthy that to adequately and effectively monitor the activities of the foreign companies which are in control of the technology, a certain degree of knowledge of the relevant skills is necessary.[916] The fact remains that the main purpose for these provisions concerning manpower training is to enable Nigerians to take their destiny into their own hands by controlling all phases of the oil industry.[917] From the look of things, these provisions have been vigorously pursued by the NNPC and the international oil companies alike. However, one finds that there is much disparity between the written and the spoken word.[918] A better view is that ideally, provisions relating to the transfer of technology should be directed towards the attainment of an ideal situation whereby an effective transfer may be made. It has been argued that:

> *"when it comes to real transfer of technology as defined above, there is a genuine divergence of interest between the developing countries and the foreign oil companies involved. Transfer of technology for petroleum exploration and development involves cost, above all in terms of time, since it consists essentially of a "learning by doing" process. For the developing country committed to acquisition of technology, the time required is whatever it takes to accomplish the learning, which may be very long. However, for the Oil Company, the time it can allow learning by nationals lasts only as long as the learning is commercially justifiable. The approach of the Oil Company based on private interest may therefore be incompatible with that of the country concerned, which is based on broader social and developmental considerations. There may also be a*

[914] *Ibid.*
[915] Atsegbua (n 475) 127.
[916] *Ibid.*
[917] *Ibid.*
[918] *Ibid.*

more fundamental divergence of interest concerning the control of the petroleum operations. In order to prolong their lucrative role, the oil companies would naturally wish to keep the developing country in a continuous state of dependency on their services, so it is clearly not in their ultimate interests to contribute actively to any process that would eventually enable the host country to dispense with their services partially or completely".[919]

Consequently, transfer of technology can be regarded as the major externality of a petroleum arrangement, and as a result has a direct bearing on the level of the host country's eventual development.[920]

The topical question is whether Nigeria should rely exclusively on the international oil company for the training of Nigerians in petroleum technology or whether it should itself make efforts to devise programmes and create arrangements which would lead to the development or acquisition of petroleum technology.[921] The fundamental problem is the issue of "control" and for Nigeria to achieve its technology goals, and effective control of the oil industry, it is imperative that technology transfer is a *sine qua non*.[922] Technology transfer is the cornerstone of any meaningful control of its natural resources and for this to be addressed, the government must be involved in the training of Nigerians in petroleum technology.[923]

A further aspect that has been adduced for lack of success in the training of Nigerians in petroleum technology is that petroleum technology, by its very nature, is sophisticated and capital intensive, usually involving considerable negotiations in foreign exchange[924]. It is important to note also that apart from the capital-intensive nature of the enterprise, the equipment needed for such technology gets outdated very quickly, because of the

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[919] Problems and Issues Concerning the Transfer, Applications and Developments of Technology in the Energy Sector: Petroleum Exploration Contracts and the Transfer of Technology. A Study Prepared by the UNCTAD Secretariat in co-operation with Terisa Turner, TD/B/C/.6/AC.9/5, at para.8.
[920] Eternality being defined as a consequence of a project which gives rise to neither costs nor benefits in terms of the project itself.
[921] Khan (n 909) 10.
[922] Atsegbua (n 475) 127.
[923] Khan (n 909) 10.
[924] O A Odiase-Alegimenien, 'Issues in the Acquisition of Petroleum Development Technology for Third World States' (1991) 15(2) OPEC Review 123, 132.

fast-changing nature of the oil industry and thus there are imperative needs to absorb new ideas to keep up with new changes and new facts of life.[925]

The fact remains that it is imperative for both parties involved in technology transfer to be committed to such development, because the acquisition of petroleum technology does not depend solely on the international oil company alone. Without full commitment on both sides, no matter how stringently technology transfer provisions are worded, they will be futile. As was proposed some years back by the United Nations Resolution 1803, the issue of permanent sovereignty can only be achieved by Nigerians through the acquisition of petroleum technology so as to take over the mantle of leadership in the petroleum industry directly. A government cannot lay claim to having permanent sovereignty over its natural resources if the technology for such attainment is in the hands of foreign companies.

What is saddening about this whole issue is the fact that Nigeria, with production of over 3,000,000 barrels per day, has no form of energy policy.[926] This deficiency has tremendous effect and has contributed to the lack of technology capability to run its oil industry.[927] Any form of legislation that is to address this issue must start with the formulation of a national energy policy.[928]

For these underlying issues to be addressed, such a policy should provide:

- Firstly, the training of Nigerians in various aspects of petroleum technology;
- Secondly, the adopting of new ideas or methods in new combinations.[929]

As a matter of fact, by law as well as by policy guidelines the Nigerian government permits the employment of expatriate technicians only until such time as domestic

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[925] *Ibid.*

[926] The average daily production for 1990 totalled 1.83 million barrels of oil, as distinct from the OPEC quota of 1.61 million barrels of oil. Source: National Press Briefing by the Minister of Petroleum Resources of his Ministry for the year ending 1990. This statement, however, was published in *The Guardian* on 1 May 1991.

[927] *Ibid.*

[928] A Adams, 'Setting the Ground Rules for a Viable National Energy Policy' (1998) OPEC Bulletin at 6.

[929] D H N Alleyne, 'State Petroleum Enterprises and the Transfer of Technology' in United Nations (ed) *State Petroleum Enterprise in Developing Countries* (New York: Pergamon Press 1980) 112.

personnel are adequately trained for those jobs.[930] It must be stressed at this point that such training is seen as an important ingredient of the process of acquiring and absorbing oil technology.[931] It was reiterated in the Ashland/NNPC contract that Ashland:

> *"Shall undertake to make the maximum use of available indigenous Nigerian manpower in the conduct of petroleum operations. Furthermore, Ashland shall within six months after the effective date and after consultation within NNPC submit for NNPC's approval a detailed recruitment programme and within twelve months, submit for NNPC's approval a training programme for all Nigerians employed by Ashland in the conduct of all petroleum operations in accordance with the Petroleum Decree 1969. For example, the provision for a minimal Nigerian representation or 50%-70% for skilled worker and 100% for unskilled worker."*[932]

The fact remains that for there to be proper technology transfer, this process invariably involves borrowing, adapting and experimenting with new ideas in our fund of scientific knowledge.[933] A former minister has reiterated in a press briefing: "The ministry in consultation with appropriate agencies in the petroleum sector of the economy has produced a draft policy for the industry. The object is to develop immediate and long-term policies and pursue programmes that will enable our oil industry survive and compete internationally"[934]

5.3.10 Title to Equipment:

There are, however, some clauses enshrined in PSC contracts for the efficacy of the transfer of technology. Most agreements with some developing countries contain a

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[930] Petroleum Act as amended. The issue of employment of expatriates in place of Nigerians has being causing serious conflicts between Nigerian employees in major oil companies and the management of those companies. See front page of *This Day* newspaper 2005 April 27 & 28.
[931] Atsegbua (n 475) 127.
[932] Gidado (n 392) 165.
[933] Allenyne (n 929) 113.
[934] M Kassim-Momodu, 'Petroleum –New Government Policy' (1990) 8 JENRL 149. See also Atsegbua (n 475) 127.

provision that equipment brought in for the work programme shall become the property of the host country at a specified time.[935]

Under the Ashland/NNPC contract, it is expressly provided that all equipment purchased for the performance of the contract is the property of the NNPC.[936] However, Ashland is required to recover the landed costs. Ashland is required to use this equipment. The fact remains, however, that such a right cease upon termination or expiration of the contract. For instance, under the Venezuelan contract, this provision is more detailed as: "the land and permanent works including the installations, accessories and equipment forming an integral part thereof, and any other assets acquired for the purpose of carrying out the contract, whatever the legal basis upon which it is acquired shall be conserved in order for the title thereto to be given to the Nation, without any payment or indemnity, upon the termination of this contract for any cause …when the efficiency of the operations directed to an economic development of the contracted area justifies the alienation, removal exchange or any other act respecting those assets which may affect the right of the Nation, "CVP", on its initiative at the request of the "CONTRACTOR" shall handle the application to the National Executive which, if it deems it convenient, shall give the necessary authorisation in order to carry out the act for which the application was made". [937]

Commentators are of the view that the main effect of these provisions might as well be simply to place responsibility on the host Government for the removal of equipment at abandonment.[938] Since these processes cost a lot of money, at the end of the day such a responsibility might cause the host nation to have incurred more in costs than it has gained. Another effect of such clauses might be that the company is saved a lot of

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935 Omorogbe (n 25) 96.

936 *Ibid.*

937 *Ibid;* Clause Fifteen CVP/Occidental contract.

938 Problems of abandonment are addressed in international treaties such as the Geneva Convention on the Continental Shelf, and the United Nations Law of the Sea Convention 1982 both of which place varying obligations on the states to remove abandoned or disused installations. See T C Daintith, G D N Willoughby, G F Hewitt, and A D G Hill, *United Kingdom Oil and Gas Law* (London, Sweet & Maxwell 1984) 213. The Maritime Safety Committee of the International Maritime Organisation (IMO) has guidelines and standards for the abandonment of the offshore installations, which are awaiting adoption. These guidelines would on a case-by-case basis permit leaving an installation in place, or its partial removal. Only a few states appear to have addressed this issue in their national legislation.

money and trouble since the host state is left with equipment it may never use and is solely responsible for the cost of its removal.[939]

5.3.11 Other Provisions:

Furthermore, there are additional vital provisions contained in the contract, which deal with such issues as relinquishment and exclusion of areas, and settlement of disputes. On the question of applicable law, the laws of Nigeria govern the contract, and any dispute arising will be determined in accordance with the Nigerian legal system.

Stabilisation and renegotiation clauses are remarkably non-existent in this contract. According to Eyinla, a stabilisation clause is particularly important to give the international company a status of continuity consistent with the reasonable satisfaction of commercial expectations.[940] The main reason, which is not far-fetched, is to insulate the relationship from changes in the content of the law of the host state. On the other hand, renegotiation clauses allow the terms of the contract to be adjusted to any changes of circumstances substantially and adversely affecting the interests of the parties. Under the contract[941] when a fair assessment is made of these clauses, it is observed that when they are incorporated in the contracts, the parties tend to rely on them to define the concepts of *force majeure* and hardship where they may be thought to fill the gaps left by the ordinary rules of law.[942] For the efficacy of the contract and a cordial relationship between the parties, the contract would have benefited *ab initio* from the inclusion of a renegotiation clause, since it gives the parties involved a free hand to alter the terms of the contract in future and thus avoid unnecessary bureaucracy that might be involved if the long process of passing legislation or starting the process all over again needs to be adopted to remedy any aspect of the contract which they find to their disadvantage.[943]

Thus, in contrast to the Indonesian agreements, the Ashland agreement departs from the tenets of Indonesian model. However, the Ashland agreement provides that title to available crude oil allocated to each party shall pass at the wellhead. In the case of

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[939] Omorogbe (n 25) 96.
[940] Eyinla and Ukpo (n 894) 86.
[941] *Ibid.*
[942] *Ibid.*
[943] *Ibid.*

Indonesia, it only passes when it reaches an export point. What this means invariably is that Pertamina owns the oil until it reaches the port of export before the contractor assumes title, although this might not mean much, since the passing of title has little or no economic or functional significance.[944] This is because the international oil company continues to exercise de facto control of the oil industry whether title to available crude oil passes at the wellhead or at the point of exportation as in the Indonesian model.[945] However, the fact remains that the idea of postponing the transfer of title from the wellhead to the point of export would be to ensure that the complete ownership of hydrocarbons is vested in Nigeria.[946]

In terms of control, the Ashland agreement radically departs from the Indonesian contract in vesting management and operational responsibility exclusively on Ashland.[947] In functional terms, the impact of the Indonesian provision is not noticeably different from that of the Ashland agreement and it would appear that the only significant difference is that by virtue of its formal management provisions, Pertamina definitely has greater leverage in insisting on a close inspection of all aspects of the operation of the oil companies.[948]

Pertamina, while performing its responsibilities, must consult with the contractors. This exercise is cautiously carried out so that it does not lead to confrontation with the contractors or provide them with a genuine excuse to cut down operations thus causing divestment in the petroleum sector.[949] The management provision in the Indonesian type of arrangement has an excellent opportunity for aiding them in wresting the requisite operational techniques and skills from the petroleum companies, and this in years to come will ultimately strengthen them and help in their subsequent control of the industry.[950] In the Ashland agreement, it would have been better if the agreement had spelt out expressly provisions for a transfer or proportionate sharing of management and operation functions at designated positions as soon as there is a commercial discovery. This would have enabled the NNPC to act as a watch-dog on

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[944] Asante (n 4)366.
[945] *Ibid.*
[946] Fabrikant (n 84) 37.
[947] Asante (n 4) 366.
[948] *Ibid.*
[949] *Ibid* 366-367.
[950] *Ibid.*

Ashland activities in the areas of production and marketing and would also afford NNPC officers an excellent opportunity of learning the operational techniques and skills of the petroleum company, a process which will ultimately strengthen NNPC's supervisory functions and consequently its control.[951]

In the Indonesian model, with time, the contracts were renegotiated to allow contractors maximum cost oil, equivalent to the expenses incurred.[952] It used to be limited to 40% whereas in the case of Nigeria, it was 50% as modified by retroactive legislation in 1977, and by so doing making the Nigerian cost oil the highest amongst oil producing nations in the world that operate this kind of arrangement.[953]

5.4 GENERAL ASSESSMENT OF THE CONRACTS

It has been suggested that by the very nature of the agreement *ab initio*, Ashland bears the initial technical and financial responsibility for exploration and drilling. This provision in the contract makes it particularly attractive in comparison to the joint venture, since the government is less perturbed and bears no form of financial loss in case there is no commercial discovery.

Further, another remarkable provision in the contract is the fact that the NNPC is put in an intermediary position between Ashland and government agencies. For instance, it facilitates the procurement of visas, work permits, etc.[954] By so doing, the NNPC enables Ashland to attend to the more pressing demands on it as an oil company and avoid all the bureaucratic procedures and obstacles involved in obtaining such documents.[955] This is also the position in Indonesia. Fabrikant observed that: "the prospect of having a government agency negotiating on their behalf with Indonesian officialdom. Pertamina, it was thought, could deal more effectively than the contractor with government agencies, enabling the contractors to concentrate on the principal task of finding oil. Pertamina has thus concentrated mainly on providing liaison between government agencies and the companies, and generally expediting petroleum operations by reducing

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[951] *Ibid* 366.
[952] *Ibid.*
[953] The other country with as high a cost oil allocation as Nigeria is Peru. For further details see Oil Money, Special Report No. 59 (New York).
[954] Asante (n 4) 366.
[955] Fabrikant (n 611) 366.

the likelihood of a contractor becoming entangled in the considerable government bureaucracy."[956]

As to the financial aspect, if the Ashland NNPC agreement were evaluated on that basis, it would appear that, in terms of financial gains, that production sharing arrangement does not give Nigeria enough financial returns as compared to some other countries like Indonesia, Malaysia and Libya.[957]

Furthermore, the setting aside of a percentage of production towards the payment of tax is also a departure from the normal practice. The general practice is that PSCs are subject to corporate income tax, other than in other oil producing countries like Libya, where no form of tax is payable.[958] There is a petroleum profit tax of 85% in Nigeria. Commentators have argued that the contract is more advantageous to Ashland than to NNPC, notwithstanding the fact that the bulk of the proceeds of sale go to the federal board of Inland Revenue.[959]

The contract has attracted a lot of adverse comment from many quarters. A crude oil sale Tribunal[960] was set up to probe the alleged loss of N2.8 billion from the Account of the NNPC. The tribunal in its report, however, found no sum missing but was of the opinion that "the production sharing contract has no benefit whatsoever to the NNPC as it stands today … It seems too lopsided in favor of Ashland."[961] The tribunal was of the view that after the operating company (Ashland) took its 50% for the amortisation of its investment and operating expenses, payment of royalties (as well as the additional 2% of the actual operating cost as overhead charges) and after setting aside the 55% for the payment of rent and petroleum profit tax, the balance left was hardly anything to warrant the application of any ratio whether it be 35%:65%: or 30%:70%.[962] It would appear that this criticism is very harsh, and it suggests that perhaps the full facts were not clearly stated to the Tribunal. Although the percentages available from crude oil set

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[956] *Ibid.*
[957] *Ibid.*
[958] Omorogbe (n 20) 281.
[959] Eyinla (n 894) 89.
[960] F Sasegbon, 'Current Developments in Oil and Gas Law: Nigeria – with Comparative Analysis with Other African Oil Producing Countries' (1981) 1 Energy Law 361, 371.
[961] Ibid; Report of the Tribunal of Inquiry into Crude Oil Sales (1980).
[962] *Ibid.*

aside for cost oil and tax oil are high, this does not, however, justify the tribunal criticism.[963]

Notwithstanding the fact that the percentages of available crude oil set for cost oil and tax oil were to be reduced, that change alone does not guarantee the government *de facto* control of the oil industry.[964]

Another concern of the contract is that it appears rather casually worded and subject to different interpretations as compared to several other PSCs from other countries which are extremely detailed and precise, especially as regards fiscal provision.

Also, the Nigerian PSC lacks some progressive clauses found in other PSCs. For instance, in Indonesia, the law requires a contractor to provide 8.52 per cent of total production at a highly subsidised price to cover domestic demand.[965] By contrast, the contract between Ashland and the NNPC has been discredited because it is felt that Ashland has been allowed to earn windfall profits.[966] They occur when there is a drastic increase in prices as it did happen at the start of the gulf crisis, spark off by the Iraqi invasion of Kuwait.[967]

Furthermore, it has been viewed from many quarters that "the PSC certainly has no benefits whatsoever to the NNPC as it stands today (referring to 1980)… it seems too lopsided in favour of Ashland… Ashland has taken the NNPC and this country for a good ride in the implementation of this contracts".[968]

A further concern of this contract is that since Ashland is given the right to prepare budgets and programmes with the NNPC approving them, the country will obviously be vulnerable should the contractor view this as a license to be extravagant, with the government ultimately bearing the burden. The Tribunal of Inquiry deliberated thus:

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[963] *Ibid.*
[964] Omorogbe (n 24) 342.
[965] *Ibid.*
[966] Mohammed B Umar, 'Legal Issues in the Management of Nigeria's Production Sharing Contracts from a Study of the Nigerian National Petroleum Corporation's (National Petroleum Management Services Perspective' (2005) 1 OGEL.
[967] *Ibid.*
[968] *Ibid. The Report of the Tribunal of Inquiry into Crude Oil Sales* (Lagos, Federal Government Press 1980) 6.

"The truth is that the NNPC bears 100% of all expenditure incurred by Ashland which is a company incorporated in Nigeria for the purposes of executing the contract between the NNPC and Ashland Oil incorporated of the USA. They are agents of the NNPC who, contrary to what should be expected from a prudent investor, blindly pays for all types of expenses put up by Ashland without question."[969]

From the above it can be argued that the NNPC wants to be in a vital position whereby it can contribute meaningfully and question Ashland's excesses. To perform this task diligently, it has to be part and parcel of the preparation of the budgets and should not in any way be isolated from such task.[970] Additionally, where the contractor is aware that it holds an advantageous position, it is likely to concentrate on producing one lucrative field, whilst slowing down exploration on other areas covered by the PSC.[971] Further, the contractor, realizing that its expenses will be fully met, can afford to be wasteful or extravagant to the eventual disadvantage of the host country.[972]

It has also been observed that there is no strict restriction in the contract as to how the company dispenses oil to either affiliates or non-affiliates.[973] Some contracts provide that "no commission shall be paid on any sales to any affiliates", i.e., expressly permitting commission only on sales to non-affiliates. Several contracts are silent on this question, however, and at least two contracts expressly permit commission paid on sale to any affiliates "so long as they do not exceed the customary and prevailing state." Such disposal could be disadvantageous to the host government, for example, if such sale is done at an artificial price that may raise the recoverable cost.[974]

Putting some devices in place dismantles such a lacuna in the Indonesian model. For instance, it is provided that if Pertamina is unable to secure a higher price than the contractor for cost oil, the contractor must either match the price obtainable by Pertamina or permit Pertamina to sell the oil on its behalf.[975] Further, the government

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[969] *Ibid.* Report of the Tribunal of Inquiry into Crude Oil Sales (1980).
[970] *Ibid.*
[971] *Ibid.*
[972] *Ibid.*
[973] Fabrikant (n 611) 346.
[974] Eyinla and Ukpo (n 894) 90.
[975] Fabrikant (n 611) 318.

prohibits contractors from giving discounts or commission to their affiliates. Nonetheless, the efficient working of this provision depends very much on Pertamina's marketing and its ability to identify affiliates' transactions. It guarantees Pertamina the right to check and supervise the company's activities.[976] In the Ashland/NNPC contract no such rights exist. Instead Ashland is given more rights than it actually deserves, for instance, to sell the cost oil as well as the tax oil besides its own share. The only remarkable difference is that it should be at prices fixed by the NNPC, which are periodically fixed for various categories of Nigerian crude.[977]

It has been suggested that the operating company has a vested interest in the prices fixed by the NNPC lest it find itself in a difficult situation with regard to disposing of all its crude. The PSC allowed Ashland (in exercising its marketing rights) to sell all or a portion of the marketable quantity of oil to itself, but only at the price fixed by the NNPC.[978] It may not be totally wrong to suggest that the operating company plays a notable role in determining prices fixed by the NNPC. Such price was usually at the applicable NNPC's periodically announced official selling prices for various categories of Nigerian crude.[979]

However, the anomalies created by the NNPC and Ashland PSC, such as the high price of petroleum profits tax (85%) and the high level of cost oil allocation, rendered the oil split insignificant thus leading to the three amendments that the subject PSC underwent between 1977 and 1992, these were essentially piecemeal and thus deemed insufficient.[980] Recently, it has been proven that PSC can be improved by incorporating into it specific provisions to safeguard different interests which are inadequately provided for in a standard PSC.[981]

Yet another concern with the arrangement with Ashland is that it may earn what is usually known as windfall profit. This usually occurs when there is a drastic increase in the price of oil as was the case during the Gulf crisis. This was occasioned by the Iraqi invasion of Kuwait and its attendant consequences. Nonetheless, Atsebua asserts that

[976] *Ibid.*
[977] *Ibid.*
[978] Atsegbua (n 475) 16.
[979] *Ibid.*
[980] Akinrele (n 430) 160.
[981] Hossain (n 260) 158. See also Omorogbe (n 24) 347.

production sharing agreements have been popular with corporations because "they control their own shares of the crude oil and barring any election by the state oil company to take its share in kind, they can control the destination of the state oil companies' share. Most importantly companies have been able, on the share of their crude oil, to enjoy the whole of the price increase in the world market".[982]

This anomaly can be corrected by incorporating into the contract certain kinds of mechanisms to check such price increases for instances of windfall profits which the international oil may earn. For example, windfall price increases have been dismantled in Angola by the inclusion of price cap clauses, so that where there is a price rise, the state expressly retains any excess profit that might accrue as a result of such increase in crude oil prices.[983]

Another area of the contract which was of concern was the problem of eliminating slow exploration of certain fields by the international oil company. For example, in Nigeria, whereas previously the International Oil Company was obliged to have carried out exploration of at least 50% of the contract area within ten years, this period has now been reduced to five years.[984] Such provisions have certainly resulted in a speeding up of the exploration activities of the International Oil Companies.[985] Whether or not this will be agreeable to the International Oil Company, it has been suggested, is not so much attributable to the group of contracts known as PSCs as to the variant of the PSC that was operative in Nigeria.[986]

From the above findings it can be safely concluded that there is no doubt that the PSC has contributed immensely to the government realising its objectives of maximising its revenue from the oil industry, but in terms of ultimate *de facto* control of the oil exploration, production and marketing and the development of the other aspects of

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982 Lawrence Atsegbua, 'Acquisition of Oil Rights under Contractual Joint Ventures in Nigeria' (1993) 37 Journal of African Law 10, 19.

983 *Ibid.*

984 Omorogbe (n 24) 347.

985 *Ibid;* In Nigeria, if there is a sharp increase or decrease in oil price the contract can be renegotiated with international oil company.

986 *Ibid.*

petroleum operations, it has failed woefully.[987] It is quite doubtful whether the issue of control has been given enough consideration in this instance.

Also needing to be considered is whether the PSC is compatible with the principle of permanent sovereignty over natural resources. The UN General Assembly declared: the right of the people and nations to permanent sovereignty over natural wealth and resources must be exercised in the interest of their national development and the well-being of the people of the state.[988] In exercise of the above rights Libya in 1973 and 1974 promulgated decrees purporting to nationalise all the rights, interest and property of Texaco Overseas Petroleum and California Asiatic Oil Company. The tribunal upheld the reliance of Libya on the import of the Charter while demanding the immediate, adequate and prompt payment of compensation.[989] The argument of the plaintiff that the UN resolution was not of a binding force and should not be relied on by the defendant was rejected[990] the free and beneficial exercise of the sovereignty of the peoples and the nations over their natural resources must be furthered by the mutual respect of states based on their sovereign equality.[991]

The UN Declaration on the Economic Sovereignty of States firmly occasioned the introduction of the new international economics as confirmed in the 1974 Declaration of the Charter of the Economic Rights and Duties of States.[992] For instance, in exploitation of the minerals and resources in the developing countries before this time, agreement with natives was based on traditional concession agreements; the International Oil Companies made a token payment to the locals, if they wished.[993] The illiterate elders and kings having no clear impression of what they were asked to sign, signed most of these concession agreements; thus, they signed away their natural wealth and mineral resources, a factor that in no way improved their standard of living.[994]

In the absence of control by Nigeria of the oil industry, the compatibility of the PSC with the principle of permanent sovereignty over natural wealth and resources is seriously in

[987] *Ibid.*
[988] UN Resolution 523(v1) of January 1952.
[989] Omorogbe (n 24) 347.
[990] *Texaco Overseas Petroleum v Libya Arab Republic*, [1977] 17ILM 1 P 389.
[991] UN Resolution 1803.
[992] Charter of Economic Rights and Duties of States (1974) A/RES/29/3281.
[993] Omorogbe (n 24) 347.
[994] R L Buell, *International Relations* (New York: Holt and Company 1929) 397-98.

doubt. It is therefore contradictory to suggest that the evolution of the oil agreement from the traditional concession regime of the repealed Mineral Oil Ordinance of 1914 to PSC has led to the attainment by the government of its objectives.

The problems which have persisted and that were present in the traditional concessions are still prevalent in the PSC Agreements. It has been argued that as petroleum assumes increasing importance in the world economy, the foreign oil companies are now left with no choice but to compromise, in fact, most of the traditional prerogatives that they have enjoyed in the underdeveloped world. The PSC, in particular, stands out as an important effort to equalise the historic imbalance between the host country and the foreign oil company. Although such contracts seem to exaggerate the actual shift in power between the parties, they provide an appearance of equality as well as a means for ultimately achieving such equality.

The fundamental truth is that the new arrangement, as well as the traditional concessions which have been renegotiated, have one thing in common and that is that they are all vehicles which allow the multi-national oil companies to exploit the host countries to a greater or lesser extent. The new arrangement provides for the increased if not total ownership and control or management of the whole enterprise by the host government but in practice, the reverse is the case. It is important to note that in evaluating the relative merits of these forms with a view to making a choice among them one must at the substance of the arrangement. look behind the form and labels. Hossain corroborated this view by arguing that "labels, titles, appellations or headings given to contracts do not change their nature. Only their contents and substance determine their nature".[995]

5.5 MODERN ERA PSCs IN NIGERIA

The post-1992 PSCs sought to address some of the concerns of the Ashland/NNPC contracts. Adequate provisions were made for the allocation of the crude oil proceeds between the contracting parties namely, the corporation (the NNPC) or the holder (the

[995] Hossain (n 260) 109; See also J E Attwell, 'Changing Relationships between Host Countries and International Petroleum Companies' (1979) 17 Houston L R 1015. Here, the writer submits that, "one must look at the substance of each agreement to determine the bottom line financial benefits as well as the controls that are in the particular contractual arrangement chosen." Also in A Z El Chiati, 'Protection of Foreign Investment: Petroleum Agreements' (1987), *Academie De Droit International* 63.

Oil Prospecting License or OPL holder, i.e. an indigenous holder) on the one hand and the contractor (an oil exploration and production company on the other hand. Provisions were made for a contractual period of 30 years (10 years of exploration and 20 years of production) with a provision for relinquishment of parts of the contract area.[996] Provisions, however, are put in place for effective control and the management by the NNPC, which is not dissimilar to the role of the joint operating committee in the joint operating agreement (JOA) applicable to the traditional joint venture arrangement.[997]

5.5.1 Allocations:

The allocation of crude oil for cost oil is regulated by the provisions of the Petroleum Act as amended, the Petroleum Profit Tax Act (PPTA) as amended, the Deep Offshore and Production Sharing Contract 1999, as amended, and the provisions of the contract with respect to production split. The 1991 model PSC differs greatly from the 1990 model. Major changes are in respect of the recovery of operating costs and the crude oil allocation. Article (8) provides that:[998]

(a) Tax oil, to offset actual tax and royalty due, will be deducted in full in the relevant year. The government agency shall take in kind, lift and dispose of tax oil and from the proceeds pay royalty and petroleum profit tax and concession rentals.

(b) Cost oil: for cost recovery purposes, operating cost will be recovered in the year of expenditure, while capital cost will be recovered in a minimum of 20 quarterly installments. The contractor shall take in kind, lift and dispose of cost oil and from the proceeds pay all operating costs.

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[996] Paragraph 12 and 19 of the First Schedule to the Petroleum Act and paragraph 2 of the Petroleum Regulations (Drilling and Production) provide for the relinquishment of the contract area. See also Clause 4.

[997] The committee consists of officials of both the NNPC and the contractor, whose prior approval (based on unanimous decision) must be had before incurring expenditures that are over certain fixed levels. Additionally, work programmes and budgets are reviewed and approved by the Committee to ensure the propriety of operations. These safeguards do not however provide absolute protection against the tendency to incur unreasonable expenditure and concentration on the joint venture operations producing fields at the expense of new and potentially risky fields.

[998] Deep Offshore and Inland Basin Production Sharing Contracts Act (1999).

(c) Profit oil: being the balance of crude oil after deduction of royalty, petroleum profit concession rental and cost recovery. Profit oil for the Niger delta area in the south of the Nigeria will be shared between the parties based on the agreed sharing formula.

5.5.2 Royalties:

Royalties payable for the Offshore and Inland Basin PSC are determined in accordance with section 5 of the Deep Offshore Act 1999, whereas royalties for the Onshore and Shallow Water PSCs are enshrined in the provisions of the Petroleum (Drilling and Production Amendment Regulations 2003.[999] Royalty rates in the deep offshore areas are graduated according to water depth.

5.5.3 Management provisions:

In terms of the management provisions of the newer PSC, there are gross lacunae in these PSCs provisions. The fact is that the Petroleum Act did not envisage the introduction of the PSC at the time it was enacted in 1969 and has remained substantially superfluous. According to Umar, the Act is either silent on or does not substantially address many important concerns affecting the legal rights and obligations of the parties under a PSC.[1000] This includes the absence of specific provisions on the obligations of the PSC contractors independent of the corporation, as the provision of the Act and terms of the OPL and OML refer only to the holder of the license or lease, in this case the NNPC, and not a contractor for services.[1001]

Furthermore, the provisions of the contract, particularly the 1993 contract, have created loopholes and ambiguities and as a result, compound the ineffectiveness. Examples of this consist of provisions requiring the contractor to execute the work programme (in accordance with best industry practice), the obligation of the contractor to patronise local contractors as far as is conceivable to do so provided they meet the mandatory standards, and the liability to the corporation for reservoir damage or pollution or any

[999] Pursuant to sec. 9 of the Petroleum Act *supra*.
[1000] Umar (n 966) 51.
[1001] *Ibid* 51.

consequential losses or damages occurring including, but not limited to, lost production and lost profit.[1002]

The Act provides amongst other things, for the amendment of certain enactments to give legislative effect to the fiscal incentives given to the oil and gas companies operating in the Deep Offshore and Inland Basin areas under Production Sharing Contracts or such Production Sharing Contract type arrangements between the Nigerian National Petroleum Corporation or other holder of oil prospecting licenses and various petroleum exploration and production companies concerning the terms of the production sharing contract.[1003]

5.5.4 Incentivisation:

The Nigerian government has offered substantial financial incentives to attract investment in deepwater explorations such as:

(a) The requirement that cost oil be allocated to the contractor in such quantum as shall generate an amount of proceeds sufficient for the recovery of operating costs. Also included is the specification of royalties payable at a rate lower than that obtaining under the concessionary arrangements.

(b) Forming part of the financial incentive is the reduction in the profits payable as petroleum profit tax. Section 3(i) of the Deep Offshore and Inland Basin Production Sharing Contract as amended, stipulates it at 50% flat rate of chargeable profit for the duration of the contract. This represents a reduction of 35% from the 85% stipulated by the Petroleum Profit Tax Act as amended, parties to Production Sharing Contracts are bound by any other taxes, duties or levies imposed by any federal, state or local government or area council Authority.

(c) Also, there are investment credit and investment tax allowances. The former which are enshrined in section (4) of the Deep Offshore and Inland Basin Production Sharing Contract, as amended, is restricted to qualifying capital

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[1002] *Ibid* 53.
[1003] *Ibid.*

expenditure made by the parties in respect of the Production Sharing Contract executed prior to first of July 1988. It can be argued that to qualify, such expenditure must have been made wholly, exclusively and necessarily for the main purposes of petroleum operations carried out under the terms of the Production Sharing Contract in the Deep Offshore or Inland Basin. Investment credit is enjoyable at a flat rate of 50% of the qualifying expenditure. The fact is that the chargeable tax is the amount of assessable tax less offset of which ITC is an item. The chargeable tax so derived shall be split between the NNPC and the contractors in accordance with the proportion of the profit oil split.[1004]

(d) Cost recovery: it is expressly provided in the Act that PSCs which do not place any cap on cost recovery provide that cost oil allocated to the contractor shall be sufficient to cover its operating costs consisting of (1) Tangible Drilling costs, (2) Capital Expenses (3) Intangible Drilling costs and (4) Qualifying Non-Capital costs.[1005]

(e) Ring-fencing of operating expenses: these are usually operating expenses that were earned on different OPLs and are said to be ringed-fenced by statute.[1006]

Notwithstanding these attractive fiscal incentives, operators have been reluctant to make the huge financial investment to take the operation into production because there was no specific legislation which dealt with the Production Sharing Contract since all that existed were mere agreements between the NNPC and the foreign oil companies

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[1004] The exact interpretation of the provision of the Deep Offshore Act, and the PSC vis-à-vis the PPTA had been a subject of disagreement between the Corporation and the Contractor.

[1005] See Capital Cost shall be recoverable in full and chargeable in equal instalments over a five (5) year period or the remaining life of the contracts, whichever is less. Amortisations of such costs shall be in accordance with the method prescribed under the Second Schedule of the PPT Act, or over the remaining life of the contact, whichever is less. Qualifying Non-Capital Costs are, on the other hand, recovered in the year of expenditure. Also, certain operating cost are taken into account and deducted when calculating the chargeable profits for the purposes of Petroleum Profits Tax, in accordance with the Petroleum Profits Tax Act (PPTA).

[1006] Section 8 Deep Offshore Act. But there are unsettled questions about the proper interpretation of the section which are discussed in chapter 4. Ring fencing is defined as "a procedure where by the cost of drilling a dry hole in one production sharing area cannot be taken as a deduction in computing tax due on revenues from another production area. This means any tax offset is limited to costs incurred in a particular production sharing area. It means also that even if a discovery is made in one production sharing area, any tax/cost recovery in that regard will not occur until after production and revenue operation have commenced." See Adepetun (n 906) 25.

which were not legally binding, and which were considered unenforceable.[1007] The inconsistencies in the PSCs and the PPT led to a concerted call on the government by the operators to give these terms some sort of legislative backing.[1008] The promulgation of the Deep Offshore and Inland Basin Production Sharing Contracts Decree No. 9 and Amendment Decree No. 26 of 1999 (PSC law) specified the essential terms of the PSC, thereby providing the much-needed stability. The said Decree was gazetted in April 1999 but was made retroactive and is subject to be reviewed in January 2008 and thereafter every five years.[1009]

5.5.5 Stabilisation and arbitration clauses:

Any disputes arising, are governed and construed in accordance with the laws of the Federal Republic of Nigeria. Both the 1993 and 2000 PSCs provide for the economic stabilisation of the contract where the interests of the parties are seriously eroded.[1010] The 1993 PSC specifically provides for compensation when the rights and obligations or the economic benefit of the contract are negatively affected by an enactment of, or change in the laws or regulations of Nigeria or any rules, procedure, guidelines, instructions, directives, or policies regarding the contract adopted by any government parastatals or agencies.[1011] On the other hand, the 2000 PSC stipulates only for such amendments to the contract as are essential to reinstate, as far as is visible, such commercial benefits as existed under the contract at an effective date.[1012]

5.5.6 Termination:

The popular view is that the provisions of the 1993 PSC on termination are fairly generous to the contractor. Also, they contain broad provisions concerning the material breach of the contractors obligations as well as a failure by the contractor to

[1007] T Adigun, 'The Lurer into Oil: Gas' (1996) The Guardian 20; This new productions sharing contracts have attracted the oil companies because of the fiscal and legal regimes. The oil companies are given a higher profit share for the more marginal high-risk projects.
[1008] Umar (n 966) 49.
[1009] The Act is retrospective although issued on March 23 1999, it is viewed to have come into operation in June 1993. See also section 19 Deep Offshore Act and the appraisal of the new production sharing contracts in Nigeria (1996) OGTR 436, 436.
[1010] Umar (n 966) 49.
[1011] *Ibid* 49.
[1012] *Ibid* 49. The PSC provides for a binding and enforceable arbitration in Nigeria pursuant to the Arbitration and Conciliation Act (1990) Laws of the Federation of Nigeria Cap 19.

significantly execute the agreed work programme after the sixth year from the effective date.[1013]

By contrast, the 2000 PSC allows NNPC to terminate the contract if: (1) the oil company defaults in the performance of any part of its obligation set out in the specific provisions of the contract, (2) it fails to pay the agreed bonus and/or to fully execute the agreed minimum work programme and (3) if the warranties given by the contractor that it has, along with its affiliates, sufficient funds both in foreign and local currency to carry out petroleum operations are found to be false.[1014]

It is fair to say that both PSCs provide that a foreign oil company can at any time at its sole discretion relinquish its rights and terminate the contract if, at the end of the sixth year from the effective date, petroleum has not been discovered in commercial quantities within the stipulated contract area and if no petroleum is found under the contract at the end of ten years from the effective date.[1015]

The most recent production sharing contract is the 2005 model. This 2005 model PSC stipulates a cost recovery ceiling between 60% to 80%of available crude in each development area less deduction of Royal oil in any accounting period.[1016]

5.6 CONCLUSION

There is no doubt that the new PSCs have attracted the oil companies because of the fiscal and legal regime. The oil companies are given a higher profit share for the more marginal, high-risk projects. By these agreements, the oil companies are offered more favorable terms for frontier areas in a bid to secure their level of oil production in the next century. Any further innovation in the area of cost would continue to attract capital flow into the industry and also provide incentive for the foreign oil companies. By these

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[1013] *Ibid* 49.
[1014] *Ibid* 49.
[1015] *Ibid* 49.
[1016] The 2005 PSC introduced new terms such as: Commercial Discovery and Declaration of Commerciality; Assignment, Representative, Representations and warranties; Reviews/Renegotiations of Contract and Fiscal Terms, Valuations of Petroleum Productions; Conflict of interest; and Transparency. – *Journal of Energy Technologies and Policy* ISSN 2224-3232 (paper) ISSN 225-0573 (online), Vol. 5, no. 3, 2015.

new PSCs, Nigeria has shown a preference for these forms of arrangement. Although other forms of agreement do exist in Nigeria, they are relegated to the background.

The Nigerian government's preference for PSCs is understandable since they provide it with the needed cash flow for the industry and the foreign oil companies are attracted to them because of their attractive fiscal provisions. It can be claimed that under Production Sharing Contracts the host country enjoys a better leverage than the contractor. In addition, the other important features of a PSC that makes it particularly attractive to the host government include the fact that the philosophy of permanent sovereignty finds fuller expression in a PSC than any other alternatives. The ability for the PSC to combine these features with other stipulations such as crypto[1017] taxes, domestic market obligations, taxes and loyalties, and power of termination, which are common in concessions, makes it particularly attractive and the preferred granting instrument for the host government.

The PSC also places an emphasis on the mutuality of interest in the relationship. Both parties in a PSC express their commitment to carry out the contract in accordance with the principles of goodwill and good faith. The fact cannot be denied that a substantial improvement has been achieved by the PSC over all previous arrangements, which substantially ignored the importance of these principles. Despite these factors, it is surprising that the investor finds the PSC acceptable. The only reason for this being so can only be put down to the fact that the investor has little or no choice, since he needs the host government's oil and the host government, in turn, needs his capital and technology. Also, the PSC enables both the host country and the investor to allocate risk where appropriate.

From the preceding chapter, the next chapter will deal with devices that are now in place for balancing the risk of the investor, companies have tried to deal with the risk involved in petroleum transactions by spreading that risk, insuring against risk; or creating contractual devices for risk management like renegotiation clauses, stabilization

[1017] There are taxes additionally borne by the investor, but which are not usually captured in the government stake statistics like bonuses, training fees etc. See Article 6.11 and 10 of EQE model PSC note 15 therein. See also D Johnson 'International Petroleum Physical System Analysis and Design' (2004) CEMP.

clauses and in the cause of acrimonious relationship, choice of law clause to help the affected partner.

CHAPTER 6

BALANCING TRANSNATIONAL INVESTMENT AGREEMENTS – RENEGOTIATION, STABILISATION AND CHOICE OF APPLICABLE LAW.

6.1 INTRODUCTION

The exploration and exploitation of petroleum resources places the transnational oil company in an exceptionally multifaceted business arrangement with a foreign company. This understanding links the government who owns the resources with the transnational corporations who have the technology, capital and equipment necessary for such development in a sector where the stakes, risk and profit margin can be very high.[1018] What emerges, however, is that some States have looked askance at the phenomenon and tried with varying degrees of success to minimise or eliminate its role in their economic development process.[1019] There is no doubt that most States would welcome such inflow of foreign capital and know-how provided they are assured of control over its deployment and the general effect it is to have on their economies. The worst fear amongst developing countries which play host to foreign capital is that the owners of the capital may dominate the local economy and subsequently exert, directly or indirectly, undesirable political influence on the local scene.

The basic underlying issue is that these petroleum agreements involve a large initial outlay of capital, and long-term investment in projects, including exploration appraisal and development[1020]: investments that must be recovered from the earnings. These investments expose the transnational oil company to significant risk for an extensive period of time. There is the economic risk that the natural resource sought may not be discovered or may not be commercially exploitable or that the industrial or commercial enterprise may turn out not to be profitable under the local and world economic conditions then obtaining. At the same time, because petroleum prices are volatile, it seems that what may at first have seemed a profitable agreement for the country can

[1018] M Coale, 'Stabilisation Clauses in International Petroleum Transactions' (2002) 30 Denver Journal of International Law and Policy 227.
[1019] S K Date-Bah, 'The Legal Regime of Transnational Investment Agreements that is Most Compatible with Both the Encouragement of Foreign Investors and the Achievement of the Legitimate National Goals of Host States' (1971) 15 Journal of African Law 241.
[1020] Thomas A Walde and George Ndi, 'Stabilising International Investment Commitment: International Law Versus Contracts Interpretation' (1996) 31 Texas International Journal 215, 227.

look unattractive after it is entered into, particularly if the transnational company's work proves highly productive.[1021] The host country may attempt to change the terms of the agreement unilaterally in its favour or even to terminate the agreement in its totality and appropriate the project for itself.[1022] These factors coalesce to put weight on the foreign company to seek fine-tuning for long-term agreements in response to political pressures and changed circumstances. On the other hand, the transnational oil company tries by all possible means to avoid the renegotiation of the agreement, the effects of successive changes to the country's law or even a complete nationalisation of the company's assets.[1023]

The matter of contractual stability represents a major source of conflict between the transnational companies and the host governments. On the one hand, the interests of the transnational companies are served by stability and predictability in their contractual relationships with the host governments while on the other hand, the host governments favour a more flexible contractual regime.[1024]

Furthermore, the legal institutions arduously established to protect foreign investment in the past have been found to be grossly inadequate to meet the nationalistic demands of the newly powerful countries. The access of a great number of newly independent countries to the community of nations, many with ancient cultures or new economic regimes far different from those dominating the international community in the past, is bound to put unprecedented strains on this consensus.[1025] According to Geiger, the long duration of these contracts makes most of them vulnerable to political or economical pressures which were unforeseeable at the time of conclusion of the contracts. Unlike the economic risk, the political risk becomes greater as the project prospers.[1026] The foreign corporation contemplating an investment under an economic development

[1021] *Ibid* 227.
[1022] Christopher Curtis, 'The Legal Security of Economic Development' (1988) 29 Harvard International Law Journal 317, 318.
[1023] Walde and Ndi (n 1020) 233.
[1024] Asante (n 742) 404.
[1025] Muir J Dapray, 'The Changing Legal Framework of International Energy Management' (1975) 9 International Law Journal 605.
[1026] R Geiger, 'The Unilateral Change of Economic Development Agreements' (1974) 23 International and Comparative Law Quarterly 73, 76.

agreement faces a dilemma: if the project fails, the company bears the loss; if it succeeds, the host government may seek to appropriate the gains.[1027]

A basic underlying principle is that when a transnational company tries to spread its risk, it usually tries to form joint ventures to create a united and stronger front against a domineering host country. Companies have tried to structure and manage, through actions that include association with the host state, low visibility in the project, and flexibility in the investment to be able to adapt to changing pressures and expectations.[1028] Also, the company can try to reduce risk by including in the contract clauses that provide for international arbitration, choice of law, renegotiation and stabilisation. This chapter examines the Renegotiation clauses, stabilisation clauses and choice of law clause and the direction these clauses have assumed in recent years.

6.2 RENEGOTIATION CLAUSE

Renegotiation clauses are mainly provisions for contractual stability and provide effective alternatives to complete nationalisation.[1029] Host countries have suffered from terms and conditions which have been imposed on them for exceptionally long periods of time as a result of their initially extremely inferior bargaining power and ability, and need these to be modified in order to allow them to achieve material and effective sovereignty over their non-renewable natural resources.[1030] Policies based on such objectives have clashed powerfully with the interests of the transnational oil companies in protecting investment conditions by relying on major exporting western countries. On the other hand, associations of producer countries such as OPEC[1031] and predominantly

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1027 Curtis (n 1022) 319.
1028 Walde and Ndi (n 1020) 234.
1029 W Peter, *Arbitration and Renegotiation of International Investment Agreements* (Dordrecht, Netherlands: Martinus Nijhoff 1986) 146.
1030 Thomas W Walde, 'Revision of Transnational Investment Agreements: Contractual Flexibility in Natural Resources Developments' (1978) 10(2) *Lawyer of the Americas* 265.
1031 OPEC has taken a particularly strong stand on the revision of agreements in petroleum where changes of costs, prices, profitability rates, bargaining power and bargaining sophistication have clashed with the long duration of concessions. In Resolution XVI, OPEC has declared that governments have a right to renegotiate contracts when operators receive "excessively high net earnings after taxes." Such renegotiations shall apply to the financial terms of the concession and OPEC has laid down rather concrete rules to determine excessive profits as well as criteria to be used for renegotiation. It is remarkable to discover the parallels between the OPEC standards and the comparable standards in the U.S Renegotiation Act of 1951, 50 U.S.C Appx.1211-1233 (1951) (repealed 1977), and the U.S Armed Services Procurement Regulations. 32 C.F.R. 3-308 (1977). OPEC has declared that the governments shall

the United Nations have progressively supported the efforts of developing countries to provide legitimacy for renegotiation of existing contracts. Such developments can be seen as the evolution of an alternative new legal order confronting traditional international law as generated by Western industrialised states. The essential instruments, relating to Permanent Sovereignty Over Natural Resources (PSONR) in their topical form[1032] affirm the nationalisation of foreign owed mining operations to be the inalienable right of host countries. The notion of Permanent Sovereignty Over Natural Resources has been in use as a key factor of the NIEO (New International Economic Order).[1033] The concept of nationalisation entails the State's right to impose renegotiation of an existing arrangement as an alternative to a complete takeover by the government. As such, the revision of existing agreements has become a main goal of authoritative UN instruments pertaining to the NIEO.[1034]

Unhappily, renegotiation clauses have only been infrequently incorporated into investment agreements, notwithstanding that numerous renegotiations have been entered into in the recent past. Even though commentators have often championed these clauses, private parties involved in these international transactions have included them infrequently.[1035] There is no consensus amongst commentators as to why there appears to be reluctance for the provision of such clauses. This hesitancy may stem from fears that these clauses will make the contractual relationship unpredictable, raise the overall costs of the transaction and be unenforceable or, if the tribunal is called

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be entitled to determine the new financial conditions unilaterally if the operator refuses to comply with the renegotiation demand.

[1032] Mughraby (n 256) 161.

[1033] Declaration on Permanent Sovereignty over Natural Resources, G.A. Res. 1803, U.N GAOR, 17th Sess., Supp. No. 17, at 107, U.N. Doc. A/5217 (1962); Charter of Economic Rights and Duties of States, G.A. Res. 3281, U.N. GAOR, 29th Sess., Supp. No. 31, at 300, U.N. Doc A/9631 (1974). See generally Jiminez De Arechaga, Eduardo *Legal Aspects of the New International Order* (1980); T W Wälde, (1982) in A Requiem for the 'New International Order": The Rise and Fall of Paradigm in International Economic Law and a Post-Mortem with Timeless Significance; and Norbert Horn, 'Normative Problems of a New International Economic World Order' (1982) 16 Journal of World Trade Law 338.

[1034] The general assembly has generally decided that one of the five major objectives of a Code of Conduct on Transnational Corporation is basically to facilitate, as necessary, the review and the revision of previously concluded arrangements. This matter was further reiterated in an African meeting in Addis Ababa, Ethiopia in January to February 1977 pertaining to the Code of Conduct demands that "the TNCs shall accept the renegotiation of agreements which are not in conformity with the NIEO in a manner consistent with the national development objectives of the host countries."

[1035] Jeswald W Salacuse, 'Renegotiating International Business Transactions: The Continuing Struggle of Life Against Form' (2001) 35 International Law Journal 1507, 1536.

upon to adapt the terms of the contract, will result in an unenforceable decision or the tribunal modifying the contract in a way that neither party intended.[1036]

The fundamental issue is that these clauses provide a bulwark[1037] against explosive actions by host governments such as nationalisation. For instance, when in Libya the government of Muammar Gaddafi nationalised fifty-one per cent of the companies' interest in the concessions, when the companies commenced arbitration proceedings, their remaining forty-nine per cent interest was also nationalised. Libya did not respond to the companies' request to submit to arbitration, but when the companies under clause 28(3) asked the President of the International Court of Justice ("ICJ") to appoint a sole arbitrator, the Libyan government opposed such appointment in a memorandum. Libya objected to the arbitration procedure, stating that the disputes were not subject to arbitration because the nationalisations were acts of sovereignty. After considering the memorandum, the President of the ICJ named a sole arbitrator. A preliminary award was rendered in November of 1975, followed by an award on the merits in January 1977.

There would, in fact, be little preference to abrogate an undertaking if the terms of an investment agreement were to be reviewed at regular intervals. In a situation where there is no express provision for revision, the investor is invariably at an advantage relative to the host country which is in dire need of a renegotiation. Consequently, the investor can advance from a position of strength since he is under no legal obligation to renegotiate.[1038] However, it is a different scenario when the venture turns out to be exceptionally profitable, with high profits being realised by the company; the government, whether of a developed or developing country,[1039] is bound to call for renegotiations. In contrast, when prices fall to levels not anticipated within the

[1036] John Gotanda, 'Renegotiation and Adaptation Clauses in Investment Contracts Revisited' (2003) 36 Journal of Transnational Law 1461.
[1037] Omorogbe (n 25) 105.
[1038] Peter (n 1029) 154.
[1039] For instance, Norway and the United Kingdom have both had recourse to renegotiate procedures see also Peter Cameron *Property Rights and Sovereign Rights: The Case of North Sea Oil* (Academic Press 1983); this phenomenon is peculiar to most host States.

agreement, the transnational companies are the first to call for renegotiation, either unswervingly or by slowing down or entirely cutting short production.[1040]

It would appear that renegotiation provides for a balancing of the contract terms so that neither party is unjustifiably disadvantaged by the initial terms and ought thus to be regarded as a fundamental part of the investment process. This issue was reiterated in a report by a group of eminent persons appointed by the secretary general of the United Nations.[1041]

> *"While a clear understanding on various issues at the times of entry is vital, it has to be recognised that conditions change and what may seem to have been adequate and fair at the time of the entry may prove unsatisfactory to either party over time. A large number of agreements made in the past lack comprehensiveness and contain no provision for renegotiation. Developing countries have, of course, the power, through legislation, to modify the terms of agreements. But sometimes such actions, if carried out unilaterally, entail disproportionately high costs in terms of the future flow of investment. A willingness on both sides to renegotiate agreements which have been in force for more than, say, ten years could help to avoid recourse to extreme measures. The group recommends that in the initial agreement with multinational corporation's host countries should consider making provisions for the review, at the request of either side after suitable intervals, of various clauses of the agreement."*

In most international investment contracts, the inclusion of a clause allowing the parties to renegotiate the terms of their contract if certain events take place no doubt supports stability. In the case of E.D.F. v Société Shell Française,[1042] an oil company and the French national power company had concluded a contract for the supply of fuel oil. The contract contained a hardship clause providing that in the event that the price of oil would increase beyond a stated figure, the parties would "consult to consider possible amendments to the contract." In the early 1970s, there was a considerable increase in

1040 Omorogbe (n 25) 105.
1041 Asante (n 742) 413.
1042 Paris, September 28, 1976 J.C.P. 1978,11,18810. Quoted from Blinn et al (n 863) 298.

the price of oil. However, rather than conforming to the agreed clauses, both parties brought this action in the courts. The oil company sought to have the contract terminated. The company petitioned the court to set up a new price. Both actions were dismissed on the ground that the parties had an obligation to negotiate and that it was only in the event that they could not reach an agreement that the courts could reflect on the matter.

In circumstances where they are unable to arrive at an agreement, the parties at times authorise an arbitration tribunal to amend the terms of the contract in order to restore the economic equilibrium implied by the parties when they concluded in the agreement.

The renegotiation of an international agreement is possible in international law under the principle of *clausula rebus sic stantibus* which states that a fundamental change in basic circumstances of a contract justifies a revision,[1043] and in some extreme cases can lead to termination of the agreement in the instance of a change of the basic conditions on which the agreement was based.[1044] The *clausula rebus sic stantibus* principle has to be interpreted in the light of relevant UN resolutions, reflecting the consensus of at least the capital-importing countries, on the territory of which the investment is embarked on. Therefore, a far-reaching change in relation to the commodities, or an innovative change of contractual terms which gains currency in similar agreements, would grant to both host states and investors the right to require renegotiation for adjustment. It is noteworthy that transnational companies are effective and resolute on such clauses granting themselves an exclusive right of unilateral revision.

Some text writers are of the view that international law does not yield principles of adequate precision. A synoptic view[1045] of major legal systems, with a growing emphasis on the legal principles originating from the United Nations, shows that a modification of the indispensable circumstances on which an agreement was based can give rise in key legal systems to the right of readjustment, at times even termination, under such legal

[1043] Geiger (n 1026) 86. See also H S Zakariya 'Where Changed Circumstances Affect Continued Validity of Mineral Development Agreements Contracts' in K Hossain (ed), *Legal Aspects of the New International Economic Order* (New York: Frances Pinter Ltd 1980) 263 and 274.
[1044] Geiger (n 1026) 73-76 and Mughraby (n 256) 174.
[1045] Walde (n 1030) 271.

precepts and principles as "frustration," "imprévision," "contract administratif," or "Wegfall der Geschäftsgrundlage."[1046]

Furthermore, concern must also be paid to legal readjustment or termination of agreements of unduly long duration or which reflect unequal bargaining power and experience.[1047] Such principles are cited in major legal systems principally when the sovereignty of the government clashes with its contractual obligations. From the principles of major legal systems, interpreted in light of relevant resolutions of the United Nations and specified requirements of law adequate for an "economic development agreement," one may safely say that following considerable change of the major circumstances fundamental to the agreement, revision of the terms is justified. Such a right of revision could not be excluded by "stabilisation" clauses,[1048] provisions in investment agreements revealing a major bargaining weakness of developing host countries in comparison with the transnational corporation.

Walde observed that as far as fundamental legal concepts of international and domestic law are concerned, a view which asserts absolute "sanctity" of contracts can barely be sustained. Renegotiation and readjustment can be satisfactorily justified by a change in the vital circumstances fundamental to an agreement. In natural resources contracts of very long duration where there has been considerable instability in the underlying conditions, there is consequently much room to claim for renegotiation.[1049]

Conversely, as the circumstances giving rise to genuine renegotiation are difficult to define accurately, and as the development of standards to readjust contracts has not advanced very far, either in substance or in agreement, the requirement of precise conditions, procedures, and criteria for renegotiation may be preferable to a reliance on controversial and rather indistinguishable principles.

As Hawkins and others suggested, it is not always straightforward to distinguish between renegotiation and nationalisation. This complexity is obvious, mainly in instances where the host country forces the investor to agree to a limited or complete

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[1046] Geiger (n 1026) 73.
[1047] *Ibid*.
[1048] R Brown, 'Choice of Law Provisions in Concession and Related Contracts' (1976) 39 Modern Law Review 6 and Geiger (n 487) 73.
[1049] Walde (n 1030) 272.

take-over whilst carrying on some or all operations under modified terms. The absence of a gap between coercion and negotiation gives rise to gloominess on the part of the transnational company, especially when projected onto the background of past investments made on different terms.[1050] On the other hand, renegotiation may be distinguished by the fact that revised terms are embodied in an agreement which constitutes some form of extension of the transnational's activities.

Furthermore, it would appear that renegotiations are a less consequential response to a change in investment conditions than are total revisions of the contract, and are therefore far less noticeable and consequently less well documented. Renegotiations tend to overlap with changes in the host State's investment conditions or a change in laws or regulations. Such changes may also be in substance indistinguishable from an intended or previously closed renegotiation with the transnational company which now comes to be influenced by the new terms. A good number of cases of renegotiations reviewed are accompanied by or heralded by key changes in the investment and tax regulations of the host country:[1051]

There is a popular view that renegotiation appears more the rule than the exception. Renegotiation has the benefit of eradicating a number of obstacles host countries have come across after nationalisations, such as problems in operations, in expansion of existing facilities, in marketing, and financing.[1052] Early renegotiations involving considerable revision were, in the beginning, concentrated in the area of petroleum exploitation, but the signal produced by the strong petroleum producing countries has subsequently been followed by weaker petroleum producers and by host states producing non-fuel minerals.[1053] Obtainable joint-venture and service contracts in petroleum have, to a large extent, been unchanged by renegotiation insofar as the host

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[1050] Robert G Hawkins, Norman Mintz, and Michael Provissiero, 'Government Takeovers of U.S Foreign Affiliates' (1976) 7 Journal of International Business Studies 3-16.

[1051]See Sec. General, Sovereignty over Natural Resources, U.N. Doc. E/C.7/53(1975) (hereinafter U.N. Permanent Sovereignty); Robert Brasseur, 'International Legislation and Fiscality of Hydrocarbon' (1976) 5 37; Norman Girvan, *Corporate Imperialism, Conflict and Expropriation: Essays in Transnational Corporations and Economic Nationalism in the Third World* (New York: Myron E. Sharpe 1976) 98.

[1052] It is on record that host countries have come across a series of obstacles, particularly countries like Peru, Bolivia (Patino), Chile (Kennecott/Anaconda). Theodore Harvey Moran, *Multinational Corporations and the Politics of Dependence: Copper in Chile* (Princeton, N.J. & London: Princeton University Press 1974) 315.

[1053] Winston McCalla, 'Taxation of Bauxite Resources: The Jamaican Model' (1977) 5 Black Law Journal 280.

State's participation and control were concerned.[1054] Such relative immunity to the storms of change experienced in the traditional concessions suggests that companies who opted for more flexible agreements and conceded a larger share of partnership and control to the host State, were able to achieve a higher degree of stability in their contractual terms. Far from undermining the stability of agreements, renegotiation provides a assort of insurance against that kind of explosive reaction generated by the bitter realisation that the investment agreement itself emphatically rules out any rational process of revision. There would be little inclination to abrogate an agreement or nationalise an undertaking if the terms of an investment agreement could be reopened, say, every five years.

In the petroleum sector, the most significant characteristics of recent renegotiations have been the participation of the host State, the multiple rises of posted prices, rises in royalty and tax rates, the removal of certain rebates, and the imposition of excess profits taxes. Renegotiation of oil concessions resultant in participation by the government of the host country has not completely eliminated the role of multinational corporations; they still continue to deal with the host States under new arrangements such as long term sales contracts on rather favourable terms and long term technical assistance agreements.[1055] The terms thus renegotiated then go on to strongly influence negotiations of subsequent new contracts which are then more easily brought into line with the standard and objectives already achieved by the host countries in their renegotiations of older contracts and vice versa.

There is a prevalent view that since the advent of the trend in renegotiated agreements to increasingly subject the transnational investors to national laws of general application, the traditional enclave status of the foreign investors has plummeted and conditions have shifted in favour of modern types of investment regimes.[1056] There is no denying the fact that Companies are increasingly taking to sophisticated forms of non-equity control, such as management and long-term purchase as well as marketing arrangements, with the objective of holding on to material control despite having to

[1054] H S Zakaharia, 'New Directions in the Search for Development of Petroleum Resources in the Developing Countries' (1976) 9 Vand. J.Transn'l L. 545, 572.
[1055] Asante (n 742) 415.
[1056] Walde (n 1030) 275.

surrender to complete national ownership. This notwithstanding, the result of recent renegotiations is the development of more sophisticated forms of agreements, bringing older concession models in line with the modern evolution of the transnational investment agreement. Renegotiation is not an exception, but rather a main feature of modern large scale, and long-term investment contracts.

Renegotiation is available to transnationals seeking to change the agreement in times of recession and depressed prices and thus it can be an effective means of stabilising the contract.[1057] If appropriately restricted, renegotiation clauses can serve as stabilisation clauses that differ from real stabilisation clauses only in their limited effect on stabilisation over time or with regards to substantive matters. The triggering events for renegotiation that have been chosen by parties are indicative of the possibilities of renegotiation

It would appear that the chances for a renegotiation clause to function in practice are dependent, above all, on the prerequisites for initiating a consensual procedure being clearly defined in the clauses.[1058] On the other hand, and in direct contradiction to the necessity for existing definitions, it is the nature of these clauses that they can never cover every conceivable case.[1059] Article 47(b) of the Ghana/Shell contract requires "such changes in the financial and economic circumstances relating to the petroleum industry, operating conditions in Ghana and marketing conditions generally as to materially affect the fundamental economic and financial basis of this Agreement." The latter formulation makes clear the issues involved with this sort of renegotiation clauses. The change in the commercial balance of the contract can barely be defined more concretely. Trigger events evade a detailed definition as they are complex, unforeseen, and influenced by naturally volatile economic determinants. These clauses can be classified as "general review clauses." Other clauses, however, link the trigger of the procedure to the occurrence of one or more events defined more precisely in the clause, such as tax increases, price changes for raw materials, or that a specific risk materialises (special risk clauses).

[1057] Peter (n 1029) 154.

[1058] Horn (n 1033) 129, observing that the defining of a particular event which will trigger review is the most salient feature of a special review clause.

[1059] William F Fox, *International Commercial Agreements* (3rd edition, 1998) 221 argues that "express contractual language will not totally eliminate risk, there is virtually nothing that can accomplish this".

There is also the possibility for the host country and the transnational company to try and restrict the clause to a particular subject matter such as taxes from the date of the conclusion of the contract.[1060]

It would appear that Renegotiation has the advantage of eradicating a number of difficulties host countries have come across after nationalisations, such as problems in operations, in expansion of existing facilities, in marketing, and financing.[1061] It is worth mentioning that formerly existing joint venture and service contracts in petroleum have to a large extent been unchanged by renegotiation insofar as the host government participation and control are concerned.[1062] Such comparative immunity to the wave of change qualified in the traditional concession advocates that the companies who are amenable to more flexible agreements and who have accorded a big share of the partnership and the control to the host country have been able to attain a higher degree of stability in their contractual terms.[1063]

Some commentators from capital exporting countries have argued that the atypical characteristics of an investment agreement between a government and a foreign company make it comparable to an international agreement and as a result subject to such international legal doctrines as *pacta sunt servanda* (agreements must be kept). The legal consequences of this reasoning would be that a State would not be entitled to unilaterally modify or abrogate contracts to which aliens are parties.[1064] The practical effect of this principle would be to exclude the renegotiation or the review of investment agreements or other transnational contracts at the instance of the host country government. A further consequence of this principle would be that the contractual interest of the alien would then constitute an acquired right which cannot be withdrawn even upon the payment of prompt, adequate and effective compensation.[1065]

[1060] Atsegbua (n 982) 165.
[1061] Moran (n 1052) 315.
[1062] Zakariya (n 251) 572.
[1063] Walde (n 1030) 275.
[1064] Louis B Sohn and R R Baxter, 'Responsibility of States for Injuries to the Economic Interests of Aliens' (1961) 55 AJIL 545.
[1065] For the recent discussion of this theory in its entire traditional ramifications, see 'The Award of the Sole Arbitrator in the Dispute Between Texaco Overseas Petroleum Company/California Asiatic Oil Company and the Government of the Libyan Arab Republic' (1978) XVII International Legal Materials 1.

Another approach to protect the foreign investor is by an attempt to insulate the contract from the operation of the law of the host country by categorising the investment agreement as an independent and self-sufficient system of law, regulating the whole range of relationships between the host country and the transnational company without reference to any domestic law.[1066] If parties decide to include a clause allowing an arbitrating tribunal to modify the terms of the contract in the event of the parties being unable to reach an agreement through renegotiation, it would be helpful to the tribunal if the parties provided some sort of criteria to guide the extent of adaptation. Indeed, as noted above, without any guidance, a tribunal may well be reluctant to adapt the contract.[1067]

6.2.1 Reasons why Renegotiation Clauses are Obligatory

The prevalent view is that renegotiation may become imperative by reason of the fact that the transnational company concerned has concluded a series of such liberal agreements with neighbouring countries.[1068] In such a situation a sort of most favoured nation clause comes into operation. These most favoured (country or company) provisions stem from the practice of commercial treaties in international law. The grant of better conditions in a subsequent agreement to the party of the first agreement can be stipulated to be automatic, or it may give rise to a right to call for renegotiation of the first agreement. Most favoured company clauses are quite frequent in some concession contracts.[1069] Transnational companies have therefore retained the unilateral right to revise contractual terms in their favour. Such provisions, however, have been criticised in that they hinder governments in their successive negotiations and are therefore difficult to implement, as it is difficult to single out individual provisions granting better conditions to the subsequent partner from an array of other

[1066] Asante (n 742) 405.
[1067] Final Award of 4 May 1999 (*Ad hoc*), reprinted in 25 Y.B. Com. Arb. 13. 61; Award in Case No. 1512 (ICC 1971), reprinted in Collection of ICC Arbitral Awards, 1974-1985 3, 4 (Sigvard Jarvin & Yves Derains eds. 1990).
[1068] Asante (n 742) 413.
[1069] Particularly in agreements of transnational corporations with francophone countries in Africa. Such provisions favouring the company are frequent, see, e.g. the uranium agreement between the Central Republic and the French C.E.A. of 1969, art C.F., Journal Official May 26 1969. In addition, petroleum agreements before 1970 contain such clauses, a few examples will suffice, Kuwait –K.O.C. OF 1966, in 28 P.L.M.E.A.-I(SUPPL) Iranian – Iminoco of 1965 in 4 O.P.E.C. The main aim for the transnational is to prevent another company from gaining a competitive advantage.

considerations and stipulations in the whole agreement. The rapid evolution of petroleum concessions, normally initiated in one country and leap-frogging to other countries, has brought about a larger number of most favoured nation clauses favouring the host country.[1070] This permutation of the short-term period for the length of the agreement, collectively with the rights for renewal, under the terms prevailing at the time of the renewal, appears to be a flexible and mutually accepted way of adjusting mineral contracts without generating avoidable conflicts.[1071]The object of these provisions is to enable host governments to benefit from more favourable terms which transnational corporations subsequently concede to other countries. In some cases, most favoured nation clauses are confined to a particular region, such as Africa or the Middle East. For instance, in 1967, Nigeria invoked a most favoured African nation clause in securing a general review of its petroleum agreements with a transnational corporation in consonance with the terms which were conceded by such transnational corporation in Libya.[1072]

An example of a most favoured nation clause contained in the 1980 Abu Dhabi concession[1073] provides that:

> *"If, in the future, arrangements are made between the government of Abu Dhabi and any other states in the Middle East or the agent of such government and the company or any other company/companies operating in the petroleum industry as a result of which an increase in benefits should accrue generally to all such governments aforesaid, the government and the company shall review and discuss the changed circumstances within the petroleum industry in order to decide whether any alteration in the terms of the agreement would be equitable to bothparties."*

Infrequently, a change of government brings in a new regime which is more ideologically dedicated to the control of the premeditated sectors of the country's economy and results in consultation for equity participation in the foreign-owned

[1070] In petroleum agreements, see Abu Dhabi – Mitsubishi of 1968, 26 P.L.M.E.A.-. (Suppl) and Kuwait-Hispaniola of 1967, 25 P.L.M.E.A.-(Suppl).
[1071] Walde (n 1030) 294.
[1072] Smith and Wells (n 561) 137.
[1073] Article 68 of 1980 Concession Agreement between the Government and Sceptre Resources/Scimitar Oil/Wington Enterprise/Amerada Hess Corp.

enterprise. The country may also be faced with ominous economic difficulties which may oblige the government to turn to the foreign enterprise as a source of increased revenue. Once more, a broad evaluation of the fiscal policies of a country may make it almost unfeasible to eliminate the foreign investor with exceptional concessions from the domain of the new measures. At times, technical formula for determining a rate would be a legitimate ground for renegotiation.

Renegotiation should thus be recognised as a basic facet of the foreign investment process. In this view, OPEC has declared that changed economic circumstances provide a justifiable basis for host governments to renegotiate petroleum agreements. In Resolution No. XVI. 90 of 1968, OPEC affirmed that governments have a right to renegotiate contracts when transnational corporations serving as operators obtain "excessively high net earnings after taxes." Such renegotiation shall apply to the financial terms of the agreement. OPEC has approved existing rules to determine excessive profits and also the criteria to be used for such renegotiations.

Generally there is a view that in recent times, the Secretary-General of the International Centre for Settlement of Investment Disputes has supported the espousal of renegotiation and review clauses in investment agreements as a mechanism for circumventing or containing conflict and investment disputes.[1074] In its Programme of Action on the Establishment of a New International Economic Order, the General Assembly clearly specified that one of the five most important objectives of a code of conduct incumbent on transnational corporations is to smooth the progress, as obligatory, of the review and revision of formerly completed arrangements.

Occasionally, renegotiation has taken place at the demand of transnational corporations, in situations where perseverance on the original contractual terms would have caused substantial hardship to the corporation. A study of several cases of relations between host governments and United States subsidiaries has concluded that host governments have almost always resorted to renegotiation as a means of changing the terms of investment, and that such a method is favoured over absolute nationalisation when the fundamental incentive is economic. Renegotiation is therefore a main characteristic of

[1074] See the Annual Report of the Secretary to the Administrative Council, 1974 and 1975.

modern, large-scale and long-term investment contracts in natural resources. The pattern and results of negotiation are an indication of the superiority achieved by the host country in developing the necessary skill to exercise control over its natural resources.[1075]

It would appear, however, that renegotiation is not a panacea,[1076] and it has many downsides. Investors may refuse to include renegotiation clauses in their contracts for very many reasons. First and foremost, they may reduce contract stability.[1077] It cannot be denied that a renegotiation clause may interpolate uncertainty into the contractual arrangement. Businesses value certainty and predictability[1078] and predictability have been identified as a key element to a favourable climate for foreign investment.[1079]

For instance, certainty in any business climate reinforces agreement. In 1978, the International Chamber of Commerce promulgated rules for the adaptation of contracts. With time such rules were withdrawn because they were hardly used due to the fact that practitioners viewed adaptation clauses with scepticism, preferring instead the principle of *pacta sunt servanda*.[1080] U.S. businesses are known to be reluctant to include compelled renegotiation and adaptation clauses, both because of the legal system's reliance of *pacta sunt servanda* and because of the fact that such clauses are not as frequently used in common law countries, as they are in civil law countries such as Germany and The Netherlands.[1081]

Another potential downside is that renegotiation clauses may come at a cost.[1082] When confronted with uncertain economic return, an investor may refrain from entering into the investment agreement or structure the investment in such a way as to increase

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[1075] *Ibid;* An internal paper prepared for the United Nations Centre on Transnational Corporations by Thomas Walde.
[1076] Gotanda (n 1036) 1463.
[1077] Peter Klaus Berger, *International Economic Arbitration*, (Boston: Kluwer Law & Taxation Publishers 1993) 1362.
[1078] See generally 'A Report on the ICC Rules of Contractual Relations' (1994) 5 ICC Bull. 31.
[1079] Jeswald W Salacuse, 'Direct Foreign Investment and the Law in Developing Countries' (2000) 15 Foreign Investment Law Journal 382, 387.
[1080] Laurence W Craig, William Park and Jan Paulsson, *International Chamber of Commence Arbitration* (3rd edition, Oceana Publication 2000) 710.
[1081] Joseph M Perillo, 'Force Majeure and Hardship Doctrine Under the UNIDROIT Principles of International Commercial Contracts' (1997) 5 Tul. J. Int'l & Comp. L. 5, 26-27.
[1082] Salacuse (n 1079) 387.

returns to offset the risk created by the environment.[1083] If a host state authorises such a clause in any foreign investment contract, the State runs the risk to lose the foreign investment or have to pay more for the investment of capital. In the light of the increased uncertainty, the investor would seek a higher return on the investment than that investor would otherwise require, so raising the overall transaction cost.

Furthermore, it would appear that if a renegotiation clause is included in an investment contract, in the event the parties are unable successfully to renegotiate the terms of their contract it is unclear whether a dispute would exist between the parties.[1084] Without a dispute the arbitral tribunal may not be able to exercise jurisdiction and even if it does the tribunal may be unable to decree an enforceable award.[1085] It has also been held that where the parties are unable to reach an agreement in renegotiation there is no breach of contract because an obligation to negotiate is not an obligation to agree,[1086] and thus mere failure to agree does not constitute a real dispute between the parties.[1087]

Commentators have favoured the view that there is not always a dispute when the parties request an arbitral tribunal to adapt a contract; others disagree.[1088] If the applicable national judiciary refuses to consider the request for a tribunal to adapt the terms of a contract owing to a dispute over terms, then the arbitral tribunal may have the authority to adapt such a contract. On the other hand, if the tribunal exercises jurisdiction inappropriately, any decision to adapt the contract may be unenforceable under the New York Convention.[1089]

[1083] *Ibid.*

[1084] Emmanuel Gaillard and John Savage (eds), *On International Commercial Arbitration* (Kluwer Law International 1999) 22-29.

[1085] *Ibid.*

[1086] Award in the Matter of an Arbitration Between Kuwait and the American Independence Oil Company (Aminoil) March 24, 1982, reprinted in I.L.M.976, 1004 (1982). See also Gotanda (n 1036) 1465.

[1087] Georges R Delaume, 'ICSID Arbitration: Practical Considerations' (1984) 1 Journal of International Law of Arbitration 101, 117. It was stated that "disputes regarding conflicts of interest between the parties, such as those involving the desirability of renegotiating the entire agreement or certain of its terms, would normally fall outside the scope of the (ICSID) Convention"; Christoph Schreuer, 'Commentary on the ICSID Convention' (1996) 11 Foreign Investment Law Journal 318, 339-40. It was stated that "(t)he dispute will only qualify as legal (under the ICSID Convention) if legal remedies such as restitution or damages are sought and if legal rights based on, for example, treaties or legislation are claimed".

[1088] Delaume *Ibid.*

[1089] Convention on the Recognition and Enforcement of Arbitral Awards, June 1958, 21 U.N.T.S. 38 (Codified at 9 U.S.C. 201-08(1988)). It may be mentioned that the 1986 Netherlands Arbitration Act

A further concern, as already mentioned, is that the adaptation clause may provide the tribunal with little or no guidance upon which to modify the terms of the contract. In such a situation the tribunal may refuse to adapt the contract. Yet if the tribunal adapted the contract without any criteria to apply, the outcome could be one to which neither party would have agreed at outset.[1090]

Another concern is that by allowing renegotiation and adaptation clauses to be triggered by events which are within the control of the host government,[1091] these clauses are said to be operating in place of stabilisation clauses by allowing the host country to change its law in ways that can affect the economic equilibrium of the contract.[1092] Applying a renegotiation and adaptation clause in these circumstances might increase the likelihood of a host State taking some action that would cause the investor to invoke the renegotiation provision. According to Wolfgang, if the contract contained such a clause and the project turned out to be profitable, there would seem to be little downside for a State to take such action as might change the economic structure of the arrangement.[1093] As a result, the State will entitle the investor to seek renegotiation as a matter of course. Therefore, the best the investor could then hope for would be a restructuring of the deal that would put it in the same position economically as if the host State had not taken action. However, on the other hand, the negative aspect for the host country would be minimal, because the tribunal would be unlikely to restructure the transaction to make it worse for the State in the light of the profitability of the project. Besides, the upside could be very lucrative if the restructuring were to provide the host country with more economic benefits than initially envisaged.

In Nigeria, for instance, there are no renegotiation clauses in the contractual arrangements at present in use in the Nigerian Oil Sector. Nonetheless, the Transnational Oil Company and the Government have been able to renegotiate certain aspects of their agreements. For instance, because of the drop in substantial exploration

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provides that parties may agree to submit to arbitration "the filing of gaps in or modification of the legal relationship between the parties. (Netherlands Code of Civil Procedure Art. 1020(4).)

[1090] Final Award of May 4, 1999, reprinted in 25 Y.B. Com. Arb. 13,61; Award in Case No. 1512 (ICC 1971), reprinted in collection of ICC Awards, 1974-1985 3,4 (Sigvard Jarvin &Yves Derains eds., 1990).

[1091] Berger (n 1077) 1351.

[1092] *Ibid*.

[1093] Peter Wolfgang, 'Arbitration clauses and renegotiation clauses' (1986) 3 Journal of International Arbitration 29, 31.

activities, it became obligatory for the Government to sign an MOU between the Nigerian Government and the Transnational Oil Company.[1094] This Memorandum of Understanding between the Nigerian Government and the Transnational Oil Company contains all the benefits of renegotiation clauses, as it makes it feasible for the parties to renegotiate their agreements when circumstances change.[1095]

In recent times, one of the consequences of renegotiation has been the development of more sophisticated forms of agreement, thereby bringing concession models more in line with the modern evolution of transnational investment agreements. Renegotiation is not an exception but rather a main feature of modern, large scale and long-term investment contracts. It is, however, not confined to the relations between transnational companies and host countries.[1096]

There is a growing body of opinion in recent years, that trends in the natural resources industry reveal the increasing use of renegotiation clauses because they are mutually beneficial to both the interests of the host country and those of the transnational company. It can be safely said that notwithstanding the fact that it is difficult to recommend a renegotiation clause, a properly drafted clause that utilises the triggering event provision is capable of reconciling the conflicting principles of *pacta sunt servanda* and *clausula rebus sic stantibus*.

There is a prevalent view amongst text writers such as Walde, that one characteristic of the older concession agreements was that they contained stabilisation clauses, whereby such contracts did not make renegotiation obtainable whatever the changes that may have occurred in the circumstances. The State was not allowed to resile from the contract even if the transnational corporation was making a profit far in excess of its initial investment. In modern contracts, clauses provide for sporadic reassessment of the contract[1097] and for renegotiation of the terms if major changes occur which have an effect on the contract.[1098]

[1094] The Memorandum of Understanding was signed in 1991. Press statement by the Minister for Petroleum Resources.
[1095] Atsegbua (n 475) 19.
[1096] Walde (n 1030) 275.
[1097] *Ibid*.
[1098] *Ibid*.

It has been argued that that the relative bargaining strengths of the foreign corporation and the host government vary over the duration of the course of the investment. An American expert has propounded that a modern investment contract is only an invitation to a ball.[1099] If there is no flexibility in the contract, acrimonious relationships could develop between the parties.

The existence of renegotiation clauses makes harmonious relations between the parties possible and enables the corporations to keep the social objectives of the host State in mind in pursuing its profit objectives.[1100] The renegotiation clauses also emphasise the sovereignty of the host country in that at no stage of the operation is the power of the State to interfere totally relinquished.

There is a growing recognition that it is proper best practice for renegotiation to be limited to certain key provisions which affect the profitability of the venture and to be possible only after a stated period has elapsed since the previous renegotiation. There is a growing body of law which holds that in a situation where parties fail to agree on a renegotiation, then a problem might arise. Nonetheless, it is believed in some quarters that the nature of the oil industry militates against a permanent stalemate. The contract and the expectations of the parties are commanding factors supporting an acceptable negotiation.

In a situation where on renegotiation, an agreement fails to be reached, there are various options open to the parties; either the worst scenario of the termination of the contract or the adoption of some third-party intervention such as the arbitration, litigation, or recourse to a third-Party expert.

6.3 STABILISATION CLAUSE

Stabilisation clauses or freezing clauses are meant essentially to restrain the host Government from subsequently abrogating or otherwise intervening, by the exercise of State power, in the investment agreements concluded with the transnational company,

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[1099] Smith and Wells (n 561) 66-69.

[1100] Isaiah A Litvak and Christopher J Maule, 'Foreign Corporate Social Responsibility in Less Developed Economies' (1975) 9 Journal of World Trade Law 124; Theodore H Moran, 'The Evolution of Concession Agreements in Underdeveloped Countries and the United States National Interest' (1974) 7 Vand. J. Transnational Law 315.

so insulating the agreement from unilateral changes in the law of host country and ensuring ultimately that the contract is not altered, but remains stabilised.[1101] Such clauses aim to insulate the relationship from changes in the content of the law of the host country. In considering this type of clause, we will need to look at supplementary clauses with consideration of the applicable law or laws in such areas as *force majeure*, hardship provisions, or provisions for the filling of gaps in agreements.[1102]

Stabilisation may be sought by using specific contractual devices freezing the law of the host country at a point in time to the extent that the relation is governed by that law or by removing, in whole or in part, the relationship of the contract to the domestic law and subjecting it to rules of international law.

Another method to stabilise the fundamental equilibrium of the relationship between the parties is to provide that in case of a change in the host country law substantially and adversely affecting the economic benefits accruing to one of the parties, it invariably follows that the terms of the contract will be adjusted accordingly.[1103]

Transnational corporations have traditionally attempted to thwart attempts by host governments to make unilateral changes that would unfavourably affect the investors' profitability.[1104] The usual form taken by these attempts is the insertion of a clause that purports to proscribe any changes in the investor's rights that may be made by the government without the transnational's consent.[1105] Also, many transnational companies seek such clauses as a means of underpinning the parties' stated intention not to change the agreement without mutual consent.[1106]

Stabilisation clauses are not by themselves an effectual device for achieving actual stability in contract terms. The clauses are unproductive because most companies choose not to be resolute on prompt enforcement of the clause, but to a certain extent

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1101 Atsegbua (n 982) 158.
1102 Blinn et al (n 863) 302.
1103 *Ibid* 302.
1104 Asante (n 742) 404.
1105 Stephen A Zorn, 'Unilateral Action by Oil Producing Countries: Possible Contractual Remedies of Foreign Petroleum Companies' (1985) 9 Fordham International Law Journal 73.
1106 Theodore H Moran, 'Transnational Strategies of Protection and Defense by Multinational Corporations: Spreading the Risk and Raising the Cost of Nationalisation in Natural Resources' (1973) 27(2) Int'l Org. 273.

learn to live with the changed terms. Whichever adaptation of the formal contract terms occurs, if any, months or even years can elapse after the government has successfully made the changes before they have any effect. For instance, the Saudi Arabian authorities did not sign the agreement validating their ownership of the giant Aramco concession for a considerable period after the government was effectively assured full equity ownership.[1107]

It has been suggested that such clauses are indispensable and that agreements must provide against destabilisation and unilateral changes in the future if prices rise. There is also another view that anomalies can be redressed by stabilisation clauses. It is worth noting that these clauses cannot stop destabilisation from occurring, and for that simple reason, an agreement cannot be insulated from changes in the host country's laws and as such is an attempt doomed to failure.[1108] According to Asante, the position is that that the doctrines of *pacta sunt servanda* and sanctity of contract reinforced by such devices as stability clauses fly in the face of global developments as well as the extremely fluid state of affairs in developing countries. It requires no prophet to predict that correct fiscal or other arrangements cannot realistically persist in the face of the dynamic economic changes at global and national levels which have been occurring for over ten years.[1109]

It has been further remarked that such clauses may not be legally adequate to prevent a government from acting. In practical effect, they may in some situations be politically dangerous: 'If there is one thing that can expose old Colonial wounds[1110], it is for a government which is completely disgruntled with the terms of an agreement to be confronted by a provision which says that its sovereign Parliament cannot legislate without the consent of a foreign company.'[1111] Such clauses, in fact, *make* the contract basically unstable. For instance, the 1967 Bougainville Copper Agreement in Papua New Guinea which contained such clauses had to be renegotiated after years of windfall

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[1107] Hassan S Zakariya, 'Sovereignty over natural resources and the search for a new international economic order' in Hossain, Kamal (ed), *Legal Aspects of the New International Economic Order* (London & New York 1980).
[1108] ICJ Judge Rosalyn Higgins in Legal Preconditions of Foreign Investment Energy Law 86 231 at 242.
[1109] Asante (n 742) 411.
[1110] Omorogbe (n 25) 103.
[1111] John C Kinna, 'Investing in Developing Countries: Minimization of Political Risk' (1983) 1 Journal of Energy and Natural Resources Law 89, 94.

profits to the company. The one affirmative characteristic of such clauses appears to be that in the event of the breach of such a clause, a good measure of compensation could be awarded to the company by the arbitration panel, as was demonstrated in the Kuwait Aminoil Arbitration, and the Consortium case in the Iran/US Claims Tribunal.

Furthermore, some text writers are of the view that in some cases when host countries have continued to unilaterally impose upon oil companies changes in the contract, those companies have either continued to function under the revised terms without any recognised adjustment of their contract,[1112] or have surrendered their concession rights without making any claim against the government for compensation.[1113] When a company continues to operate after a host country unilaterally changes the terms of the agreement, the multinational is either considered to have consented to the new conditions or have waived the rights it might have had under the original agreement to question such unilateral change.[1114]

Long term resources and energy projects such as oil and gas exploration and mining have a serious need for stability that goes beyond short-term projects. It would seem that major financial requirements of these investors consist of swift investment recovery through step-up depreciation and pay-back, long loss carry-forward periods, reasonable royalty rates receptive to the mineral prices and a flexible system of income or cash flow-based taxation generated merely after investment recovery.[1115]

Furthermore, to avoid financial vagueness about these requirements, companies often ask for guarantees of the stability of the status quo.[1116] Every so often, these promises are made as administrative orders or regulations, although they are more regularly made through legislation or unambiguous contract provisions.[1117] The greatest concern

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[1112] Frank C Waddams, *The Libyan Oil Industry* (Baltimore: Johns Hopkins University Press 1980) 326. See also Zakariya (n 568) 6.
[1113] In the Libya case, Exxon surrendered its rights without making any claim against the government. See 'Poor Economics, Not Politics, Spurs Exxon's Libya Exit' (1981) Petroleum Intelligence Weekly 1.
[1114] As in the case of Libya, the fact that Mobil continues to operate in Libya even though under at least informal protest, could be construed as a consent or waiver.
[1115] Coale (n 1018) 221.
[1116] Walde and Ndi (n 1020) 226.
[1117] Peter Fischer and Thomas Walde, *A Collection of International Concessions and Related Instruments* 195 481 (Oceana Publications 1981). Since resource projects are usually funded to a considerable extent by the external loan financing, these financials have as their core concern the ability of the company to repay its debt. Consequently, the stabilisation of the fiscal and foreign exchange regimes are necessary

is that the host country will expropriate or nationalise the transnational company's operation.[1118] This latter, however, can happen directly through legislation, or indirectly, through meddling with the transnational's freedom to control the enterprise and make a profit.[1119]

Also, another popular view is that companies want protection from changes in labour laws that could produce an increase in employment costs, government and in-production decisions,[1120] unanticipated increases in energy and transportation usage costs, alteration in accounting rules which will result in augmented taxes, unforeseen obligation to make available infrastructures, or authorised local service and supply contracts.[1121]

Furthermore, it has been argued that the principle of *pacta sunt servanda* which requires that States fulfil treaty obligations they had undertaken is a fundamental principle of international law applicable not only to treaties but also to any agreement between a State and a foreign national.[1122] It has been contended that stability clauses in economic development agreements are absolutely binding on the host government.[1123] It is a settled principle of law that any unilateral modification or termination of the agreement of the State is regarded as an act in violation of the principle of *pacta sunt servanda* and therefore contrary to international law. This position was canvassed in the pleadings of the Swiss government in the Losinger[1124] case before the PCIL.

For the purpose of creating a concession, whether there has been the case in quasi-international law agreements, or whether one ascribes to them another character, the

requirements that leaders want to see in investment agreements. See also Z Mikdashi, 'Oil and Funding in International Financial Arrangements' (1985) 9 Natural Resources Forum 283.

[1118] Eli Lauterpacht, 'Issues of compensation and nationality in the taking of energy investments' (1990) 8 Journal of Energy & Natural Resources Law 241, 243-44.

[1119] *Ibid* 242-243.

[1120] Instances could include orders to reduce production or damaging the asset base of the investment through mandated overproduction.

[1121] Walde and Ndi (n 1020) 230.

[1122] Sornarajah (n 3) 199.

[1123] Geiger (n 1026) 77.

[1124] *Ibid*.

principle of sanctity of contract must always be applied.[1125] According to Verdross, the doctrine of quasi-international agreements is based on the idea that the contract itself represents the legal order. In his view, state contracts which are concluded in an "inter pares form" and which refer to international arbitration 'are therefore, neither contracts governed by some municipal law of some state, nor are they international treaties since they are not concluded between subjects of international law. Accordingly, these agreements… form a third group of agreements, characterised by the fact that the private rights established by them are governed by a new legal order, created by the concurring will of the parties, i.e. the agreed *lex contractus*".[1126]

However, some commentators are of a different view, they support the existence of an international contract law on other grounds.[1127] The elevation of a transnational company to the position of a sovereign state (which is inherent in the approach) militates against the structure of international law. Also, one must ask, if such Agreement can indeed be assimilated into treaties, what the effect is in such contracts of the *clausula rebus stantibus* which permits a party to a treaty to resile from the agreement on the grounds of changed circumstances. It invariably follows that the contract is invalid because its developmental goals have changed.[1128]

In many areas of the world with important petroleum reserves, the sanctity of contracts has been undermined by the assertion of the debilitating and slippery qualification of *rebus sic stantibus* (circumstances remaining unchanged) or attacks based on their unconscionableness[1129] or the circumstances of the negotiation. Freedom of management is carefully circumscribed to ensure maximum benefit to the State rather than maximum profit.

[1125] Alfred Verdross, 'Quasi-International Agreements and International Economic Transactions' (1964) 18 Year Book of World Affairs 30.

[1126] Alfred Verdross, 'The Status of Foreign Private Interests Stemming from Economic Development Agreements with Arbitration Clauses' (1959) 9 Osterreichische Zeitschrift fur offentliches Recht, N.F. 449, 451-452.

[1127] Lord McNair, 'The General Principles of Law Recognised by Civilised Nations' (1957) 33 BYIL at 7; Friedmann and Kalmanoff (n 108) 175; Geiger (n 487). The claim was rejected in the Aramco Arbitration (1958) 27 ILR 117; See also F A Mann, *Studies in International Law* (Oxford, Clarendon Press 1973) 229-230.

[1128] Geiger (n 1026) 85-86.

[1129] J Dapray Muir, 'The Changing Legal Framework of International Energy Management' (1975) 9 Int'l. L, 607.

However, it has been suggested that stabilisation clauses are baseless in the light of the principle of permanent sovereignty over natural resources. Reference is often made to General Assembly Resolution 1803, adopted in December 1962, which recognised "the inalienable right of all States freely to dispose of their natural resources in accordance to their national interest" and which provided that "the right of the peoples and nations to permanent sovereignty over natural wealth and resources must be exercised in the interest of their national development and the wellbeing of the people of the State concerned".[1130] That resolution was adopted in 1962 and represented a kind of compromise between countries seeking confirmation of their sovereign right to dispose of the their wealth and natural resources and the industrial countries seeking recognition of the necessity of honouring commitments and of treating foreign capital in accordance with the requirements of International Law. At the same time, a compromise resolution 1803 paid lip service to both interests, remained vague, and has been used by both importer and exporter ever since. It did not change international law with respect to the treatment of foreign capital, and one may ask whether it symbolises anything new with respect to sovereignty over natural resources. The aim of developing countries has been to create a norm of absolute sovereignty over natural resources.[1131] The resolution is significant in that it represents the genesis of a compromise between developed and developing countries.[1132] According to Professor Sornarajah, the basic concept of the principle of permanent sovereignty over natural resources is the rule that national law should have supremacy over the exploitation of natural resources and that any dispute relating to such natural resources should be settled by the national courts of the State.[1133]

Uncertainties have been raised as to whether a contractual clause can achieve the effect of fettering the legislative sovereignty of a State for a lengthy period of time.[1134] The State, in theory, must act in the public good as it perceives it to be at any given

[1130] The Charter of Economic Rights and Duties among States Res.3281, 29th sess., Dec.12, 1974.U.N.Doc.A/RES/3281(XXIX), 14 INT'L LEGAL MAT'L251(1975).
[1131] M S Rajah, *Sovereignty Over Natural Resources* (New Delhi 1978); Gheorghe Elian, *The Principle of Sovereignty over Natural Resources*, (Alphen aan den Rijn: Sijthoff & Noordhoff International Publishers 1979).
[1132] Wolfgang Friedmann, *Changing Structure of International Law,* (London, Stevens & Sons 1964) 138.
[1133] M Sornarajah 'The Myth of International Contract Law' (1981) 15 J. World T. 187, 210.
[1134] In Aminoil v Kuwait (1982) ILM 976, the Tribunal suggested that the clause may be valid if limited to a reasonable period.

time.[1135] It may not be possible, as a matter of constitutional theory, for a State to bind itself by a contract made with a private party, characteristically a foreign party, to restrict its legislative power. It is trite law that a legislature is bound by its own legislation and has the power to change it. That being the case, it cannot be bound by a provision in a simple contract. Like a theme of constitutional theory, the stabilisation clause may not be able to achieve what it sets out to accomplish. It may not serve as anything more than a comforter to the foreign investor, who may obtain some security from the belief that there is a promise secured from the State not to apply its future legislation to the agreement.[1136]

Furthermore, once a disagreement arises between the foreign investor and the host State, the legality of the stabilisation clause becomes a matter of discussion. States have always queried whether such a blanket surrender of sovereignty through what is in consequence a contract located under their own law can restrain their legislative sovereignty. There are two main ways in which the stabilisation clause could be attacked. In the first instance, one could question the *vires* of the officials who made the contract on behalf of the State party. The contract would more often than not have been made by officials of a State entity or of some ministry. They would usually lack the powers to commit the State to any specific requirement, particularly the requirement not to use the legislative powers of the State in a particular manner.[1137] The second objection to the stabilisation clause is that the legislative powers of a State cannot be fettered by a mere contractual provision, particularly where the exercise of such power is necessary to secure a public benefit. In ordinary terms, both objections have a great deal of validity. The first opposition on *vires* is met with the rule which states that, once the contract is made, a State is not permitted to rely on its internal laws to contest its validity. In the Sapphire arbitration, Judge Calvin reasoned on the basis that a foreigner cannot be expected to know all the laws of the State.

The second objection is met with the theory that the foreign investment contract is subject to a supranational system which can bind the local legislature, much in the same

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[1135] Sornarajah (n 3) 407.

[1136] *Ibid.*

[1137] In SPP Ltd v Egypt (1983) 22 ILM 752 the Court came to the conclusion that a State does not become a party to a contract merely because officials of a State entity and the minister responsible for the entity signed the contract.

way that a treaty can bind the State.[1138] The examination equates the foreign investment agreement to a treaty, which obviously it is not.

Some text writers have sought to overcome this problem by arguing that the defect of personality in the foreign investor could be cured by the State conferring personality on the foreign investor. It is far-fetched to argue that the multinational corporation has personality when it suits its interests and that it does not have personality when it does not, as where liability is sought to be imposed on it for misconduct or to institute a code of conduct through international instruments.[1139]

The popular view is that the theory underlying the principle that sovereignty over natural resources resides in the people, and that the State merely acts as an agent for the people. It does mean the supreme criterion to be applied in a judgment as to the validity of the contract is whether it benefits the people as a whole. However, where at any stage a State permitting the exploitation of the resources or the terms of such contracts are detrimental to the interests of the people or the economy of the country, the State can intervene in the contract, terminate it or renegotiate the terms so that it reflects the benefit of the people. It then follows that the adherence to such a principle generates a constitutional limitation on the State in international law to deal with natural resources except in accordance with the interests of the people.

According to Geiger,[1140] the doctrines of absolute sanctity of an economic development agreement appear to be unproved and rather based on biased hypotheses. There is no denying the fact that the principle of *pacta sunt servanda* has such a rigid meaning. It is however limited by considerations of good faith and equity and, in addition, as far as public contracts are concerned, by the intrinsic dominant power of the host government.

6.3.1 Types of stabilisation clauses

Stabilisation clauses can be divided into a number of types.

[1138] The fact is that treaties are seldom made with a stabilisation clause. In any event, they are subject to the doctrine which makes the obligations defensible due to changed circumstances.
[1139] Sornarajah (n 3) 410.
[1140] Geiger (n 1026) 78.

The *freezing* type of stabilisation clause freezes the legal and fiscal system and protects the contract from any change in the law or the tax system of the host country.

A second category is called the stabilisation clause *stricto sensu* which states that the governing law of the contract shall be the law of the contracting State at the time the contract was entered into, so preventing the application of succeeding changes in the host country's State law. The stabilisation clause *stricto sensu* thus purports to protect the investor against the legislative risk which could ensue from the modification of the contractual regime by legislative act. In other words, the clause is intended to switch off any legislative involvement by the host State in the contractual relationship between the parties. Such a clause usually freezes the legislation of the host country as of a given date, usually when the contract is concluded, by simply providing that the governing law of the contract shall be that of the contracting State at the time the contract was executed, thereby precluding the application of subsequent changes in the law of the contracting State.[1141]

Lastly, the *intangibility clause* provides that the host country's government may not unilaterally modify or terminate the contract. The clause requires both parties to perform the agreement in good faith. Intangibility clauses were developed to avert the consequences of the exercise by the State of its authority in contractual matters. A good example of an intangibility clause may be cited from a Togolese petroleum concession contract of 1977 where it has been commented concerning the significant provisions in article 30 of the contract that:

> *Furthermore, apart from the provision employed, the purpose of any stabilisation is to protect the agreement from the subsequent unilateral measures of the contracting State. These clauses may appear in broad form or in a narrow form that stabilises only limited aspects of the contract, such as the applicable tax regime.*[1142]

Stabilisation clauses also occur in contracts governed by national law. It has also been argued that if the contract as a whole is governed by the contracting State's own law

[1141] A F M Maniruzzaman, 'Understanding stabilisation Techniques in Production Sharing Agreements: Some Remarks' (2005) <www.gasandoil.com/ogel/> accessed 2nd January 2018, 3.
[1142] *Ibid;* Revere award, 56, I.L.R. at 258.

then the stabilisation clause, like the rest of the contract, is adaptable if the State modifies the governing law.[1143] To achieve the purpose of the stabilisation clause while respecting the wishes of the parties' choice of governing law, the clause should be viewed as an independent obligation governed by international law, regardless of the governing law of the whole contract.[1144] Sometimes stabilisation clauses are governed by international law even when other parts are of the contract are governed by the contracting State's law. This was the issue that was canvassed in the Agip arbitration. The tribunal came to the conclusion that the Congo's nationalisation of Agip's interest violated international law because it was a violation of the contract's stabilisation clauses which bound the State at the level of international juridical order.[1145] This was also the reasoning employed in the Reeve arbitration,[1146] in which the tribunal accepted that for most purposes the governing law of the agreement was Jamaican law but nonetheless held that the stabilisation clause guarantees in the agreement were governed by the principles of public international law which governed the responsibility of the State for injuries to aliens.[1147]

6.3.2 Scope of Stabilisation Clauses

The underlying principle is that stabilisation of the relationship is never total or definitive since certain matters may be barred from the scope of the stabilisation clause, or that the parties may agree that on definite points the relationship may be permitted to develop with the passage of time. In various cases, a compromise must be achieved between the transnational pursuit for total stabilisation of the legal, economic or commercial characteristics of the venture and the ordinary exercise by the host country of its sovereign prerogatives.[1148]

[1143] See, for instance, Somali Democratic Republic, Model Concession Contract South and Central Africa in *Basic Oil Laws and Concession Contracts: South and Central Africa* (New York: Barrows 1982).
[1144] Curtis (n 1022) 347.
[1145] *Agip Co. v Popular Republic of Congo* 21 *I.L.R.* 726.
[1146] Revere Award, 56, I.L.R.at 258.
[1147] The same result is suggested in a more complex manner by arbitrator Dupuy in the Topco arbitration. He suggested that a contract can be internationalized, subjected to international law as the governing law, or as the law, or as the law from which it derives its binding force and which gives the parties the right to choose another governing law – either by placing it directly under the aegis of international law or by subjecting it to the contracting State's domestic law while at the time including a stabilisation clause. TOPCO award, 53 I.L.R. at 470-71.
[1148] Blinn (n 410) 310.

Rarely, an entire agreement may be made subject to the host country's legislation. For instance, a Togo petroleum agreement states as follows:

> *Article 37: "the present agreement has been executed in the French and English languages and both texts shall be deemed to have equal force and effect and shall be construed under and be governed by the Togolese law."*

More often, the extent of the stabilisation clause may be restricted. Rather than applying the law of the contracting State as a whole, the clause may be limited to certain aspects of the host country's legislation. The clause may also rule out from its scope certain matters which are politically important and principally responsive to the host country.

To date, there have been legions of cases involving the interpretation of stabilisation clauses. In the case of Lena Goldfields v U.S.S.R.,[1149] the issue that was canvassed was that under the arbitration clause contained in the concession agreement, Lena brought a suit against the Soviet government for the payment of thirteen million pounds, on the grounds that they had been created for Lena total impossibility of either performing its obligations under the concession agreement and enjoying its benefits. The court concluded that the agreement between Lena Goldfields and the Soviet Government, while governed by Russian law in respect to ordinary matters, was subject to the general principles of law insofar as the contractual provisions safeguarding the company's position were concerned and the court ruled in Lena's favour. A similar decision was made in case of Saudi Arabian v Arabian American Oil company (Aramco).[1150]

Another view is that one positive aspect of such clauses appears to be that in the event of the breach of a clause, a good measure of compensation could be awarded to the company by the arbitration panel as happened in the case of Texaco Overseas Oil Petroleum Co./California Asiatic Oil Co. v Government of the Libyan Arab republic (TOPCO).[1151] Between 1955 and 1968, Texaco and Calasiatic, both United States

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[1149] Arthur Nussbaum, 'Arbitration between the Lena Goldfields Ltd and the Soviet Government' (1950) 36(1) Cornell Law Review 31, 42.
[1150] 27 I.L.R. 117 (1963). The general principles of law in this regard refers to…
[1151] 53 I.L.R. (1979) 389.

corporations, obtained fourteen concessions from the Royal Libyan Government. In 1973, the revolutionary government nationalised fifty-one per cent of the company's interest in the concessions. When the company commenced arbitration proceedings their remaining forty-nine per cent interest was nationalised. The annoying fact was that Libya did not respond to the companies' request to put the matter forward to arbitration, but when the company under clause 28(3) asked the President of the International Court of Justice (ICJ) to appoint a sole arbitrator, the Libyan Government opposed such appointment in a memorandum. Libya contested the arbitration procedure on the ground that the disputes were not subject to arbitration since the nationalisations were acts of sovereignty.[1152] Subsequent to deliberating on the memorandum, the President of the International Court of Justice (ICJ) named a sole arbitrator. The issue before the TOPCO arbitrator was whether TOPCO was entitled to compensation; he first rejected the notion that the concession agreement was an administrative contract. In this award arbitrator Dupuy held that Libya's violation of the stabilisation clauses in the oil companies' agreements was an unlawful act justifying an award of *restitutio integrum*, whereby Libya was required purposely to perform the agreement. This was the decision, also, in the Libyan American Oil Co. (Liamco) v Government of the Libyan Arab Republic.[1153] The sole arbitrator in that case, on analysing the stabilisation clause, found that the clause was justified not only by the said Libyan Petroleum Legislation, but also by the general principles of the sanctity of contracts recognised both in domestic law and international law. The arbitrator further found that since Liamco's concession agreements were binding, they could not validly be terminated unless there was mutual consent of the contracting parties, in compliance with the said principle of sanctity of contract and particularly with the explicit terms of 16 of the said agreements.[1154]

A stabilisation clause may lead to complexity in its execution if its intent is to insulate the investment agreement from subsequent labour legislation to the extent that such legislation may bring an extra burden to bear upon the transnational oil company. This

[1152] Von Mehren, B Robert and P Nicholas Kourides, 'International Arbitration Between States and Foreign Private Parties: The Libyan Nationalisation Cases' (1981) American Journal of International Law 476, 489.
[1153] 62 I L R 140 (1977); 20 I L M (1977).
[1154] 62 I L R 31.

introduces into the operation of the stabilisation device a biased element which may be controversial in times of contractual pressure.

In several cases, issues of taxation are not completely stabilised. To a certain extent, the scope of stabilisation is ongoing in the sense that it may be greater during the set-up period than during years of commercial activity. In such cases, the main worry of the transnational oil company is to prevent it being subject to discriminatory treatment.

In their search for stability, parties have considered that in times of fast evolution, stability may place them at a disadvantage with other competitors and make provision for conditions anticipated to safeguard their competitiveness such as "most favoured company" clauses and "most favoured nation" clauses. We have touched on these clauses earlier in this paper. This sort of clause may easily come to work to the disadvantage of the host countries in that it may restrain the State from negotiating with potential new investors to arrive at terms more favourable to the host country than those originally granted to the first investor, knowing in advance that the investor would be at liberty to claim the benefit of those terms without providing any new reciprocal benefit to the State. Besides, the automaticity of these clauses tends to work to the detriment of the host countries when, because of the administrative compartmentalisation of its agencies, one agency may act autonomously and without information exchange with other agencies. As a result, the host country may find itself exposed to modification in the treatment of previous investors without realising the cost of the change. Despite the formulation used in a stabilisation clause, there is no guarantee that, in the event of a disagreement, arbitrators will not construe the stabilisation provisions in agreement with their own view of the "real" meaning of the clause. The case of Aminoil offers a good illustration of such a state of affairs.

Stability clauses occur frequently in economic development agreements with francophone African states. A typical example is article 10 of the agreement between the French company Uginor and the Malagasy Republic.

Even though stabilisation clauses represent a valuable bargaining chip to the transnational companies,[1155] they cannot cure the intrinsic instability of these oil contracts and may in specific circumstances lead to conflict between host governments and the transnational oil companies. Inflexibility created by stabilisation clauses can still be found in international oil contracts between host governments and international oil companies. The fact is that stabilisation clauses in oil contracts may prevent host countries from achieving their goals which comprise of *de facto* control of their oil sectors and the development of technological capability in petroleum operations. In view of the fact that *de facto* control of their oil industries in several host countries is still in the hands of the transnational oil companies, they believe that the continued use of stabilisation clauses may prevent host countries from securing *de facto* control of the oil industry at the time the contract is stabilised.

In Nigeria, modern contractual agreements in the oil sector do not utilise stabilisation clauses. On the contrary, it is expressly provided in the PSC and SC (Service contracts) that no term or provision of these contracts including the agreement of the parties to arbitration shall prevent or limit the government of Nigeria from exercising its inalienable right to alter or abrogate the contract with the transnational oil companies. Nevertheless, liability for breach of contract would arise for which damages could be awarded.[1156]

To sum up, the function and significance of stabilisation clauses stems from their ability "to avoid the arbitrary acts of the contracting government."[1157] Such clauses provide motivation to the investor because they are seen as having the capability to protect the investment from harsh and arbitrary changes in laws and regulations and other acts of the government that can affect the financial premises of the project. They also act as a form of guarantee between the investor and project leaders who need a guarantee of

[1155] Peter (n 1029) 157; Roland Brown, 'The Relationship Between the State and the Multinational Corporation in the Exploitation of Resources' (1984) 33 ICLQ 218, 223, where the commentator argued that stabilisation clauses are a fruitful source of provocation and misunderstanding.
[1156] See the Libyan award case; also in Liamco and Shell BP v Libya, the arbitrators held that nationalisation was arbitrary and awarded damages. However, in Topco the arbitrator ordered *restitution interregnum*.
[1157] Letco arbitration 1987 26 I L M 647.

investment stability and predictability.[1158] Accordingly, whereas the investor sees it as an important safeguard mechanism in a PSC, the host government sees it as another incentive to the fiscal regime, particularly for petroleum.

6.4 CHOICE OF LAW

Beginning from a broad public point of view, it is obvious that in the present state of world society and the unequal distribution of capital and industrial skill necessary for the securing of a more equitable level of material civilisation, that the citizens of the highly developed countries should take on this process and receive a proper reward for their technical and financial aid. There is no gainsaying the fact that there is always a risk in these transactions that the presence of what one medieval reporter once described as "too great might on the one side, and unmight on the other", or too great commercial experience on the one side and lack of it on the other may have the result of an agreement being entered into which is unfair to the State whose government becomes a party to it.[1159] In a situation where a transnational investment contract is silent as to the applicable law, the position is that an agreement between a State and a private foreign legal person is not a treaty but a contract and the applicable law of such a contract must be some system of domestic law. The days of generous and blatant economic concession have gone. To a great extent, the rulers of the undeveloped or less develop countries have shown themselves to be astute and progressive men well able to take care of the interests of their countries in a bargain and assisted by first clause legal advice whether from their own fellow citizens or from foreigners.

One of the complexities that arises in finding a system of law suitable to international development agreements arises from the fact that many of the countries which require skill and capital from outside for the development of their natural resources are governed by some system of law that is not mature enough to deal with this transaction. For instance, under Islamic law, provisions respecting economic development agreements are certainly inadequate, if really there are any at all. What is more, the content of Islamic law differs according to particular schools of thought whose

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[1158] This is to ensure that the project can generate enough income to service and pay back the debt, among other things. T Walde and A Kolo, 'Negotiation and Contract Adaptation in International Investment Projects: Applicable Legal Principles and Industry Practices' (2003) 2(1) OGEL 3.
[1159] McNair (n 1127) 2.

teachings are to be followed, and it is understood that there are at least four schools of law. It is not surprising, therefore, that transnationals coming from countries enjoying a well-established system of national law which is familiar with contracts of this type are unlikely to be willingly disposed to enter into contracts with a foreign government that are to be regulated by systems of law which are vague, and which have not been developed to deal with this kind of transaction.

Accordingly, it is therefore not surprising to find that the negotiators of these kinds of contract and the tribunals which adjudicate them tend to look for some direction in the matter of an appropriate system of law.

McNair position is that private international law is not in itself an alternative, in view of the fact that it does not profess to be a complete system of substantive rules of law; it is adjectival and its duty is to stipulate rules for the direction of a tribunal in deciding the system of law it should apply for the solution of a matter that has been presented to it that includes a foreign element, and that its jurisdiction is with respect to that duty.[1160]

The question that readily comes to mind is: what the appropriate system of law for the regulation of an economic development agreement is made with the government of a country whose legal system is insufficient for the regulation of this type of contract. It is submitted that a completely sufficient source for the choice by tribunals of an appropriate system can be found in the intention of the parties, evident either by the express provision in their contract, as occasionally happens, or by implication from the terms of the contract and the nature of the transaction envisaged by it.[1161]

The choice of law system should depend on the intention of the parties expressed or implied, namely that most of these contracts contain provision for arbitration. Occasionally, the arbitration clause expressly specifies the system of law which should apply and every so often it contains some regulations or elements which can sometimes contribute to the solution of that problem of applicable law, for instance, by naming the

[1160] McNair (n 1127) 4.
[1161] *Ibid*.

place of the arbitration or by investing some person with power to appoint an umpire if the parties or their arbitrators disagree.[1162]

6.4.1 International Law as Applicable Law

There is a great deal of controversy amongst commentators with regards to the application of public international law to a contract between a State and a foreign private individual. Some contend that such contracts are not governed by public international law *stricto sensu*. It has been suggested by Mann[1163] that contracts between States and aliens are governed by international law if that law is chosen by the parties to be the proper law of the contract. Hitherto, Dr. Mann has made a strong case for the application of international law *stricto sensu* to economic development agreements. He has stated that:

> *"It is possible, however, for contracts between parties, only one of whom is an international person, to be subject to public international law…(a) According to the theory referred to, a contract could be 'internationalised' in the sense that it would be subject to public international law stricto sensu, that, therefore, its existence and fate would be immune from any encroachment by a system of domestic law in exactly that same manner as in the case of treaty between two international persons; but that, on the other hand, it would be caught by such rules of jus cogens as are embodied in public international law."*[1164]

He further stated:

> *'Where the parties have not expressly or impliedly provided for a law to govern their contract, a presumption in favour of international law has the great utility of assuring that the existence of, and faith in, such contracts "would be immune from any encroachment by a system of domestic law in*

[1162] McNair (n 1127) 6.
[1163] F A Mann, 'The Proper Law of Contracts Concluded by International Persons' (1959) 35 BYIL 34, 43; and F A Mann, 'The Law Governing State Contracts' (1944) 21 The British Yearbook of International Law 20.
[1164] *Ibid.*

exactly the same manner as in the case of a treaty between two international persons…"[1165].

Dr Mann contemplated that the application of international law in this case would be undertaken by national or international officials, judges, or arbitrators having jurisdiction over the contract. The substantive law which they would apply is largely derived from those principles of law "accepted *semper ubique et omnibus*," such as those which govern the interpretation of commercial treaties.[1166] The argument that international law should form the foundation of economic development agreements has been supported by contention that such agreements, because of their international correlation are in reality international agreements. This matter was reviewed in 1950 by the International Court of Justice in the Anglo-Iranian Case[1167].

This case involved a dispute which arose between Great Britain and Iran over the cancellation by Iran of a concession of the Anglo-Iranian Company (a British Company). Iran contested the jurisdiction of the Court on the basis that the dispute was between Iran and the British company and was not governed by an earlier declaration by Iran conferring upon the Court jurisdiction under an optional clause which had been contained in a concession agreement cancelled by Iran. The earlier, cancelled, concession agreement had a dual character: it was a concession to the company as well as a treaty between the United Kingdom and Iran. Iran's argument was that as the current agreement was no longer of the same dual nature and did not contain the elements of a treaty, the previously granted jurisdiction should no longer apply.

Also, it is a prevalent view that the fact that agreements often contain provisions for the possible appointment of the arbitrators by an international official can be adduced as an argument supporting the view that such agreements are governed by international law. It is worthy to note that many of the more modern agreements provide that if the

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[1165] *Ibid* 39.
[1166] *Ibid* 40.
[1167] Anglo-Iranian Oil Co. Case (1952) I.C.L. 92. See G Fitzmaurice, 'The Law and Procedure of the International Court of Justice 1951-4: Treaty Interpretation and Other Treaty Points' (1957) 33 Brit. Y.B. Int'l L. 203, 240.

parties fail to agree on the appointment of arbitrators, the President or the Vice-President of the International Court of Justice should perform that function.[1168]

Furthermore, another contention in favour of international law as the governing law is expediency. It has been observed that it is expedient to apply international law to concession agreements because it helps to overcome the problem of the unwillingness of the host State to submit to foreign law and the reluctance of the alien individual or corporation to leave the arbitration of disputes to the courts of the grantor's State.[1169] Further, it has been argued that international law has benefits both procedurally and substantively and there is less difficulty involved in drafting it into agreements than is the case with the provision of a specific law.[1170]

There are, however, two schools of thought which champion the application of public international law to such contracts: The first school of thought supports the application of international law by elevating the contract between a State and a foreign private individual to the level of an inter-State treaty;[1171] the other school of thought supports the application of international law, save in a cautious and limited sense.[1172]

The first group of commentators consider that the choice of public international law by the parties elevates the contract to the international plane and makes it equivalent to an inter-State treaty.[1173] One commentator contends that "the proposition that contracts between a State and a foreign national should be regarded in the manner as treaties between two States and hence governed by international law is both logical and desirable. In both it is argued that promises of an international scope or of an international flavour, are made, in both cases reliance is placed on the premises; in both

[1168] In the concession agreement concluded between the Anglo-Iranian Oil Company and Iran, art. 22 provided for the settlement of disputes by arbitration, the umpire of which was to be appointed by the president of the I.C.J., if the arbitrators appointed by the two parties could not agree.
[1169] Phillip C Jessup, *A Modern Law of Nations* (New York: Macmillan 1948) 141.
[1170] Lowell Wadmond, (1961) 'Arbitration Between Governments and Foreign Private Firms' (1961) American Journal of International Law 69, 73.
[1171] A F M Maniruzzaman, 'International Development Law as Applicable Law to Economic Development Agreements: A Prognostic View' (2001) 20 Wis. Int'l L.J. 2.
[1172] *Ibid* 3.
[1173] Leo T Kissam and Edmond K Leach, 'Sovereign Expropriation of Property and Abrogation of Concession Contracts' (1959) 28 Fordham Law Review 207. See also A A Fatourous, 'Key concepts in international investment arrangements and their relevance to international transactions in services' (1989) 61 Focus 4.

cases the obligation to perform those promises should be made."[1174] This was also the view in the case of Ambatielos case before the International Court of Justice. The Greek government in that case contended that the contract between the Government of the United Kingdom and Mr. Ambatielos was one between a State and a foreign national, with the result that according to the prescribed principles of international law, the Government of the State incurs a direct responsibility on the breach of the contract, for which the Government of the foreign national thereby injured is entitled to redress.[1175]

Presently, however, there is no disproving the fact that there is a fundamental difficulty with regards to the issue of equating economic development agreements with treaties, the former being between two unequal parties, namely a sovereign State and a private entity, whereas the latter is between two or more equal parties, i.e. at the least, the parties are sovereign States.[1176] The fundamental fact is that it is not only the quality of the parties that distinguishes the economic development agreement; there are other factors which make the distinction between them even more apparent.

In the arbitration between Aramco and the Government of Saudi Arabia, the arbitration tribunal rejected the contention that an oil concession should be assimilated to an international treaty governed by the law of nations and concluded that as the agreement has not been concluded between two States, but rather between a State and a private American corporation, it was not governed by public international law.

As a result, a number of developing countries stipulated in their internal legislation and international economic development agreements, the application of their domestic law to these agreements. This view has been modified by the Organisation of Petroleum Exporting Countries OPEC Resolution XVI.90,[1177] with regard to the declaratory statement of petroleum policy in member countries. The resolution recommended to member countries *inter alia* that:

> *"Except as otherwise provided for in the legal system of a member country, all disputes arising between the government and the operators shall fall*

[1174] *Ibid* 4.
[1175] The Ambatielos Case (Greece v. UK) 1953 I.C.J Pleadings 71 (May 1993).
[1176] Maniruzzaman (n 1118) 5.
[1177] OPEC Resolution XVI. 90 of the Sixteenth Conference Held in Vienna from 24th to 25th June 1968. See *Basic Oil Laws and Concession Contracts (Middle East)*, Supplement No XXXI, P, C-1.

exclusively within the jurisdiction of the competent national courts or the specialised regional courts, as and when established."[1178]

Similar to this is Decision 24 of the Andean Commission[1179] March 31 1970, according to which "foreign member countries should not include clauses which withdraw possible differences or controversies from the national jurisdiction of the recipient country." For instance, the Libyan Petroleum Law of 1955, as amended, provides that the contract "shall be governed by and interpreted in accordance with the principles of law in Libya which are consistent with the principles of international law"[1180] hence, the Libyan legislation does not espouse the view of internationalisation of the State's contract, though it approves the idea of subordination of the local law to international law. As a result, Libyan law applies in all cases save where it differs from international law.[1181]

The topical question is: what is the necessary aim of the assimilation to a treaty of an investment contract between a State and a foreign entity? The underlying intention is to disallow the State from interfering with their mutually agreed contractual rights and obligations by their own legislative or executive measures, thereby upholding the doctrine of *pacta sunt servanda*, which is the basic rule of treaty law. Under this rule, the State party cannot rely on its own executive acts or domestic legislation to avoid international obligations arising out of variation, termination or any other interference with the contract as if it was a treaty. The basic underlying fact is that the investment agreement is neither a treaty nor equivalent to a treaty.[1182] That it is treated as such invariably means that such inference or the application of treaty rules to investment agreements is totally unacceptable in the extent to which it limits the jurisdiction of the host State's legal system. As a result, in recent years there is now a preponderant

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[1178] Declaratory Statement on Petroleum Policy in Member Countries (1968), OPEC Res. XVI. 90 reprinted in 7 *Int'l Legal Materials* 1183.
[1179] Al-Saeed Mansour, 'Legal Protection of Economic Development Agreements' (2002) 17 Arab Law Quarterly 169.
[1180] Zouhair Kronfol, *Protection of Foreign Investment: A Study in International Law* (Leiden: A W Sijhoff 1972) 76.
[1181] Mansour (n 1179) 150.
[1182] Maniruzzaman (n 1141) 5.

majority of supporters amongst commentators and jurists, as well as juridical support[1183] which tends to incline to this view.

Sornarajah suggests that the assimilation of foreign investment agreements to treaties is a non-starter as the law on treaties was never developed in consideration of its application to foreign investment contracts. The observation that the Vienna Convention on the Law of Treaties could be applied to foreign investment is too fanciful[1184] to have any merit, as the convention was not made by the parties to apply to anything other than agreements between States. It is, however, superfluous to hang on to such straws if the argument that is made has any intrinsic strength.[1185]

The stark reality is that investment agreements and treaties differ considerably, not only in the quality of the parties concerned but on other essential grounds including the respective interests of such parties. It cannot be denied that the State, on the one hand, represents the interests of and welfare of its people, whereas the contracting foreign private entity, on the other hand, essentially represents its profit-motivated concern from the time it enters into such a contract in anticipation of its completion.[1186] Furthermore, it would appear that in entering into an investment agreement, the parties do not surrender the sovereignty of the State.

It has been suggested that traditional public international law lacks apposite rules to govern contracts where one party is a State. These jurists perceive an honest need to develop such an appropriate body of law under some suitable label, whether it is something such as "public international law," "general principles of law", "transnational law" or another. However, it should be brought to the conscious attention of those considering this development that the impetus for and aspirations to develop this appropriate body of law are primarily biased in favour of the protection of investors in the rule-game and has as yet done little to advance a "justice-based" legal system, that is to function as a balance between the protection of investors' interests and the needs of the developing world to ensure distributive justice internationally.

1183 The Anglo-Iranian Oil Co. Case (U.K. v. Iran), 1952 I.C.J. 112 (July 2); Amoco International Finance Corporation v. Government of the Islamic Republic of Iran, 15 Iran-U.S.C.T.R. 189, 242-43 (July 1987).
1184 M Sornarajah, 'Power and Justice in Foreign Investment Arbitration' (1997) 14 Journal of International Arbitration 103, 119.
1185 Maniruzzaman (n 1141) 6.
1186 *Ibid* 7.

From the view and arguments expressed by the authors and commentators, it can be observed that the application of international law to State contracts has been supported in several arbitral awards; it is often suggested today, of a minority of States in the United Nations. This position holds that the host State is internationally responsible for upholding its side of a contract concluded with a foreign investor.

According to Brownlie, foreign investment agreements to be of a higher status[1187] than agreements with other States and for that reason some even assimilate these agreements to treaties.[1188] These commentators rely for their authority mainly of Paragraph 8 of UN General Assembly Resolution 1803 on permanent sovereignty over natural resources which provides that "foreign investment agreements freely entered into by or between sovereign States shall be observed in good faith." The controversial assertion is that the wording is not justly framed. Further, Maniruzzaman observed further that all contracts must be carried out in good faith and it is quite baffling to attribute a higher status to foreign investment agreements. To state that they are to be observed in good faith would indicate that other State contracts are likely to be based on bad faith and may not be binding.[1189]

There is a consensus that agreement by parties to submit eventual disputes to arbitral award shall be based on good faith, equity and legal principles recognised by civilised nations or more specifically the juridical principles contained in article 38 of the Statute of the Permanent Court of International Justice. This trend of internationalisation of investment agreements has been sustained by the decisions of international tribunals.

In the Lena Goldfields case[1190] the tribunal ruled that although the concession agreement did not provide for the application of international law, nonetheless, except for matters in the U.S.S.R. subject to Soviet law, the general principles of law enshrined in the Statute of the PCIL were the proper law of the contract.

[1187] Ian Brownlie, 'Legal Status of Natural Resources in International Law (some aspects)' (1979) 162 Hague Recueil Des Cours 245, 305-9.
[1188] I Seidl-Hohenveldern, *International Economic Law* (2nd edition Dordrecht, Boston & Norwell MA: Martinus Nijhoff 1992) 154.
[1189] Maniruzzaman (n 1141) 9.
[1190] Lena Goldfield Ltd v Government of the USSR, Art. 89(1950-51) 36 Cornell L.Q. 31.

Similarly, in the case of the Ruler of Qatar v International Marine Oil Company, the arbitrators came to the same conclusion: Since the concession agreement between the International Marine Company Ltd and the Ruler of Qatar contained no provision as to the applicable law and since under Islamic Law the agreement would at least be partially void, as a result the arbitrator came to the reasoning that neither party intended Islamic Law to apply and the agreement was to be governed by the principles of justice, equity and good conscience.[1191] Accordingly, the arbitrator stated: "I cannot think that the Ruler intended Islamic Law to apply to a contract upon which he intended to enter, under which he was to receive considerable sums of money, although Islamic Law would declare that the transaction was wholly or partially void."[1192]

Furthermore, the views that the internationalisation of investment contracts go beyond national frontiers has been recognised by the French civil courts.[1193] Taking into consideration the special requirement of international commerce, they have allowed international settlements to be made in currencies other than the French franc even though French law required payment in French francs.[1194]

In the case of Tresor Public v Galakis, the Cour de Cassation (court) concluded on the validity of the arbitration clauses between a French government enterprise and the foreign private party that these would have been void as a matter of internal law (article 83, 1004 code of civil procedure), for the reason that investment contracts, made to the needs of maritime commerce, are not necessarily subject to the law of a specific state.[1195]

Economic development agreements concluded between a State and a foreign private person are based on quite a different balance of power and interests and belong to a new and rapidly expanding domain of international law: The Law of Economic Cooperation and Development.

[1191] 18 I L R (1951), p. 149.
[1192] 20 I L R (1953), 545.
[1193] Henri Batiffol, 'Arbitration Clauses Concluded Between French Government Owned Enterprises and Foreign Private Parties' (1968) 7 Colum. J. Transn. L. 32.
[1194] Cass May 17, 1927 (Pelissier du Besset v. Algiers Land and Warehouse Co.) 1927 Gaz. Pal. II, 153.
[1195] Cass May 2, 1966, Bull. Civ. I, 199.

There is a view that the internationalist advocates do not lay emphasis on the fact that international law should be used for a more reasonable interpretation of the agreement or for a better means of assessing the compatibility of the contracting sovereign State's regulatory powers with the minimum standards of international law governing the treatment of foreigners within the jurisdiction. To a certain extent, the internationalists stress the need for such contracts to escape the comprehensive and continuing authority of the contracting State as an end in itself.[1196] Thereafter, the general thesis began to appear that the parties, since they had the right to choose the systems of law to govern the settlement of disputes arising from the contract, may choose international law or the general principles of law as the law according to which disputes should be settled. Where there is no express provision to this effect, it has been argued that all clauses in the contract come under the like requirement that the proper law of the contract is international law. The objective of these claims was not to find a coherent system governing the contract but to exclude the possibility of changes in the national laws of the state affecting the contract. It goes without saying that it is the perception of many commentators that this undermines the authority of the contracting State's domestic law to deal with the dispute, even in cases where the State's own legal system functions to a very high standard.

The current trend is that when international law is chosen in addition to or as a substitute for the law of the host State as the proper law of the contract between a State and a foreign private party, it would usually mean the applicability of the rules concerning State contract and other general principles of international law applicable to the State-alien contractual relationship.[1197] It ought to, nevertheless, be noted that a few of general principles of international law claimed to be germane should apply *mutatis mutandis*, bearing in mind the *sui generis* character of investment agreements. There is a growing view in some quarters, and precisely so, that in the framework of

[1196] Sapphire Int'l Petroleum Ltd v National Iranian Oil Co., 35 I.L.R. 136 (1963). One reason given by the arbitrator for excluding the application of Iranian law in the Sapphire case was that the foreign company should be assured legal security. This could not be done since it was not within Iran's power and that of its laws.

[1197] G Van Hecke, (1981) 'Contracts Subject to International or Transnational Law' in Hans Smit, Nina M Galston and Serge Levitsky (eds) *International Contracts* (New York 1981) 183; Richard M Buxbaum, 'The Role of Public International Law in International Business Transactions,' in J J Norton (ed) *Public International Law and the Future World Order -- Liber Amicorum in Honor of A. J. Thomas, Jr.*(Littleton, CO: Fred B Rothman & Co 1987); P F Kunzlik, 'Public International Law – Cannot Govern a Contract, Can Authorize an Arbitration' (1986) 45 Cambridge Law Journal 377.

concession agreements, at least certain general principles of international law such as *pacta sunt servanda* and *rebus sic stantibus* and those relating to remedies, principally specific performance, should be applied in a rather amended way, as opposed to their *stricto sensu* application, in the light of various up-and-coming notions such as permanent sovereignty over natural resources and sustainable development.[1198] It cannot be denied that in some recent important arbitration cases, however, this attitude towards the principles of *pacta sunt servanda*[1199] and *rebus sic stantibus*[1200] in the perspective of economic development agreements has echoed throughout, ultimately. In the midst of other general principles to which arbitral tribunals often have had to resort are: the autonomy of the will of the parties, the *pactum de contrahendo*,[1201] *abus de droit*[1202], *the exceptio non adimpleti contractus*[1203], the adjustment of unjust enrichment,[1204] and the duty of full disclosure.[1205] At this point, the international corporation, with its superior indulgence and understanding of the industry and business connections, may have relevant material information at its disposal which it is under an obligation to disclose in good faith to its contractual partner, the less developed country, as it may have a bearing on its decision on the contractual matters. Consequently, this principle protects the interests of the host developing countries *in comparison with* the

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[1198] Sornarajah (n 3); Sornarajah (n 7); A A Fatouros, *Government Guarantees to Foreign Investors* (New York: Columbia University Press 1962) 136; It states "any law of contracts, national or international, is bound to start with this principle (*pacta sunt servanda*). But it cannot stop there"; Troy E. Elder, 'The Case Against Arbitral Awards of Specific Performance in Transnational Commercial Disputes' (1997) 13 Arb. Int'l L; Stephen J Toope, *Mixed International Arbitration - Studies in Arbitration Between States and Private Persons*. (Cambridge: Grotius Publications, An Imprint of Cambridge University Press 1990)165-68.
[1199] *Amoco International Finance Corporation v. Government of the Islamic Republic of Iran [1987] 15 Iran U S C T R* [189], [242]-[43]; *Aminoil v Kuwait* [1982] 21 I L M 976, 1024.
[1200] *Aminoil* paras. 97.98.98.100, *Mobil Oil Inc. v. Iran*, 16 Iran-U.S.C.T.R.3 (1987-111). Sournarajah (n 1080) 108-112, 133-35; *Abba Kolo and Thomas W. Walde*, 'Renegotiation and Contract Adoption in International Investment Projects: Applicable Legal Principle and Industry Practices' (2000) 5 I. J. World Investment 41.
[1201] *Government of Kuwait v American Independent Oil Co* [1984] 66 I.L.R. [518], [575].
[1202] *Libyan Oil v. Govt. of the Libyan Republic* [1977] 2 I L M 1, [196]; *BP v Govt of the Libyan Republic* [1974] 53 I L R [297], [330].
[1203] The ICSID 'Klockner v Cameroon: The Duties of Partners in North-South Economic Development Agreements' (1984) International Journal International Arbitration 145, 157; Jan Paulson, 'Third World Participation in International Investment Arbitration' (1987) 2 *Foreign Investment L.J.* 21. See also Redfern. I C S I D – Losing its Appeal, 3 Int'l. Arb. 98 (1987); *Banque de Montreal v. Bail L* [1992] 2Rcs [554].
[1204] *Liamco v Libya* [1981] 20 1 196; *Kuwait v Aminoil* [1982] 21 I L M 976 [565].
[1205] *Klockner v. Cameroon* (n 664) 3; Paulsson (n 1080) 145; See also Alan Redfern, 'I.C.S.I.D. – Losing its Appeal?' (1987) 3 Arb Int'l 98; *Banque de Montreal v Bail* [1992] 2 RCS [554].

mighty, well-informed and scheming international corporations in their contractual relationships[1206].

The findings of the ICSID arbitration Klockner v. Cameroon[1207] on the issue merits citation *in extenso* as follows:

> *"The tribunal's reasoning and observation underscore the need to protect an underdeveloped and politically weary country by imposing the duty of full disclosure on multinationals, which is ever so more important – here and now in the age of technological innovation and progress to the advantage of multinationals and their parent countries and also in the wake of ever-growing movements towards globalisation and liberalisation. By developing such principles or rules based on international political justice, IDL can provide an answer to such tensions of the unwary vulnerable peoples, though not of their governments on some occasions."*

6.5 GENERAL PRINCIPLES OF LAW AS THE APPLICABLE LAW

In the middle of the last century, due to a lacuna in the legal regulation of investment agreements, some commentators put forward proposals as to how the gap might be bridged. That lacuna resulted in part from the inadequacy of some of the primitive domestic law systems to cope with the intricacies of modern commercial life. As a result, there was an unwillingness, certainly on the part of the transnational companies, to select the domestic law as the law governing the transaction and this has been evidenced by provisions in many agreements for the submission of disputes to arbitration applying, for instance, legal principles familiar to civilised nations.[1208] The notion that an economic development agreement can be governed by general principles of law was enunciated by Lord McNair. He argues that the general principles of law recognised by civilised nations is the system of law to be applied to these agreements and the adjudication of disputes arising out of them.[1209]

[1206] Maniruzzaman (n 1171) 47.
[1207] The ICSID (n 1086) 157.
[1208] H G Calvert, 'The Law Applicable To Concessions' (1959) I.U. Malaya L.Rev 265.
[1209] McNair (n 1127).

A good number of economic development agreements consist of provisions which specify the application of one of the general principles such as goodwill and good faith, or the application of the principles of law common to the contracting parties and in the absence of such common principles after that, by and in accordance with the principles of law recognised by civilised nations in general.[1210]

This is also the view of article 39 of the agreement concluded between the Sheikh of Kuwait and the Arabian Oil Company of Japan of 1958, which first refers to the principles of goodwill and good faith. It subsequently provided for the application of law common to Kuwait and Japan and, in the absence of such common principles, after that in conformity with the principles of law by and large recognised by civilised states in general, as well as those which have been applied by international tribunals.

The general principles of law have been long-established by the international arbitration cases. Most of these cases deal with oil concessions. In the Arbitration between Arabian American Oil Company (Aramco) and the Government of Saudi Arabia, the tribunal came to the conclusion that:

> *"Matters pertaining to private law are in principle governed by the law of Saudi Arabia, but with one important reservation. That law must, in case of need be interpreted or supplemented by the general principles of law, by the custom and practice in the oil business and by notion of pure jurisprudence, in particular whenever certain rights which must inevitably be recognised to the concessionaire if the concession is not to be deprived of substance would not be secured in an unquestionable manner by the law in force in Saudi Arabia."*[1211]

Furthermore, a number of legal luminaries have attempted to separate the rules from which they can extract the general principles of the internal legal systems. Nevertheless, these attempts have failed in identifying such principles. This is because it is not for internal legislation in different countries to agree on an appropriate ruling in one specific

[1210] Calvert (n 1208) 265.
[1211] *Saudi Arabia v Arabian American Oil Company* (Aramco) (1969) 27 *International Law Report* 215.

matter. Therefore, some of those jurists hold the view that these principles are just general suggestions which consider the basis of different legal systems.[1212]

It is often easy to demonstrate that arguments based on general principles are intended to support an *a priori* assumption of writers using them. General principles of law have been used extensively by arbitration tribunals in extracting principles applicable to investment contracts. Given that there is an orderly pattern in their use by arbitral tribunals and standards have been built based on past awards identifying general principles, the existence of some general principles, sanctified by long acceptance within arbitral jurisprudence, cannot be denied. However, tribunals have used general principles in a manner which may not be acceptable to States. They have often selected rules that favour the promotion of investment protection and which are detrimental to the interests of the host State. This result can be explained only on the basis that the present arbitral system is inclined towards investment protection rather than towards the acknowledgement of norms that may favour developing states.[1213]

The most important is the norm relating to the sanctity of contract. This norm denies the right of the State to change a foreign investment contract unilaterally. The conception of sanctity of contract is stated to be a general principle of law. Nevertheless, the principle is taken from nineteenth-century systems of contract law which stressed freedom of contract and the bargain struck because of the exercise of this freedom. The attrition of this doctrine forms the basis of the modern developments in the law of contract.[1214] Up till now, developments which undermine the notion of sanctity of contract have been ignored and it is acknowledged as a rule of international law, to the exclusion of the exceptions that undermine it in domestic contract systems.[1215] Several jurists have endeavoured to specify rules from which they can extract the general principles of the internal legal systems. Nevertheless, these efforts

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[1212] E Langen, *Transnational Commercial Law* (Kluwer Academic Publishers 1973) 33. In Mohammed Alwan, 'The Legal Regime of Oil Exploitation in the Arab Countries: A Study in the International Economic Agreements Kuwait' (1982) 324.

[1213] For an interesting sociological work which considers the neutrality of arbitration and the possibility that arbitrators, particularly in the arbitration of foreign investment disputes, may show obvious prejudices; see Yves Dezalay and Garth Bryant, *Dealing in Virtue: International Commercial Arbitration and the Construction of a Transnational Legal Order* (Chicago Series in Law and Society, University of Chicago Press 1996).

[1214] Patrick Atiyah, *The Rise and Fall of the Freedom of Contract* (Oxford University Press 1979).

[1215] Sornarajah (n 3) 94.

have been thwarted in stipulating such principles. As previously mentioned, this is because it is not for internal legislation in different countries to agree on an applicable ruling in any precise theme. Consequently, some of those jurists have arrived at the view that these no general principles can be stipulated, other than in the form of general suggestions which consider the origins of different legal systems.

6.5.1 The Application of Domestic Law

The proper law of a State contract is usually the domestic law of the contracting State. In such an instance, the contracting State may disappoint the expectations of an investor in a number of ways. It may refuse to honour obligations owed according to the local law. Within broad limits, contracting parties are free to choose the law that will govern their agreement.[1216] The application of domestic law has been adopted by a number of government contracts concluded with foreign investors. For instance, the choice of law clause approved in the mining contract between the Democratic Republic of the Sudan and the Japanese Group of 1976 unequivocally states in Article 12 that:

> *"This Agreement shall be governed by and constructed in all respects in accordance with the law of the Sudan. Sudanese courts shall have jurisdiction to determine any matter arising from the Agreement."*[1217]

There are, however, exceptions to these rules. In a number of cases, the law of the State of the foreign investor or any national law other than the host State's law is chosen as the law applicable to the agreement between the State and the foreign investor. Article 10 of the 1980 model sales contract for FOB and CIF product sales by

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[1216] For instance, in TOPCO Arbitration 53 I. L.R. 389,442 (1977). An introductory question in most of the petroleum arbitration is which conflict of laws rules the arbitrator should apply in determining the substantive law that governs the dispute. There are two probable ways. In the first instance, the arbitrator could look into the conflict of laws rules in force at the seat of the tribunal. On the other hand, an arbitrator could apply the conflict of laws rules that he deems appropriate, without necessarily regarding the site of the arbitration, in the light of the circumstances of the case, so as to give effect to the will of the parties.

[1217] 'Abdallah El-Sheikh Fath El-Rahman, *The Legal Regime of Foreign Private Investment in Sudan and Saudi Arabia* (2nd edition Cambridge University Press 2003) 241. See also Articles 21, 22 of the contract between Yacimientos Petroliferos Fiscales (a national Argentine oil company) and Pan American International Oil Company of 1957.

the Government of Kuwait postulates the laws of England in the governing and construction of the contract.[1218]

The application of the domestic law of the contracting State can be dictated by the intention of the private foreign party. As Garcia Amador observes:

> *"Learned opinion and practice are agreed that contracts made between the Government of a State and an alien are governed, so far as their conclusion and performance are concerned, by the domestic law of that State and not by public international law."*[1219]

It has been further remarked that, "a private person who enters into a contract with a foreign government *ipso facto* agrees to be bound by the local law with respect to all the legal consequences which may flow from that contract."[1220] As a result, the rules of private international law, which may call for the application of the *lex rei sitae, lex loci contractus*, or the *lex executionis* to determine the choice of the proper law of the contract, will lead to the application of the domestic law of the contracting State.[1221]

Furthermore, the application of the national law to the contract between a State and private foreign investor can be based on practical considerations, e.g. the duty of the State concerned to serve the social and economic welfare of its people. This view is fairly evident in the United Nations General Assembly Resolution 1803 (xvii) of 14 December 1962[1222] and the UN Resolution 2185 (xxi) of 25 November 1966[1223] on the permanent sovereignty over natural resources.

From the perspective of the developing countries the preferred choice of law clause is one which provides that all disputes are to be settled in accordance with the law of the host State. It remains a fact, however, that a number of governments, particularly in

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[1218] Basic Oil Law and Concession Contracts (Middle East) Supplement No. LXVI (66), pp. 25, 29.

[1219] F.V. Garcia Amador, Special Rapporteur (1993) DOCUMENT A/CN.4/106
International responsibility. Second report by F V Garcia Amador, 'Responsibility of the State for Injuries Caused in its Territory to the Person or Property of Aliens. Part I: Acts and Omissions' 2 J. Transnat'l & Pol'y,23.

[1220] Amador Garcia and Edwin Borchard, 'Contractual Claims in International Law' (1913) 13 Columbia Law Review 460.

[1221] Mansour Al-Saeed, 'Legal Protection of Economic Development Agreements' (2002) 17 Arab. L. Q. 172.

[1222] The General Assembly adopted the Resolution by 87 votes to 2 with 12 abstentions.

[1223] The General Assembly adopted the Resolution by 104 votes to 0 with 6 abstentions.

the early periods of oil exploration on their territory, have sometimes agreed to the law of the investor's home jurisdiction.[1224] In general, major natural-resource agreements provide for some wholly or partially internationalised choice of law.[1225] It would appear that in the case where the particular formulation applies the law of the host country generally, it nonetheless provides that international law shall apply whenever there is a lacuna in the host State's legislation. Another form of internationalisation, less appropriate to developing countries, applies international law or general principles of law whenever that law conflicts with the law of the host country.[1226]

It is sometimes suggested that where a State contract is governed by the local domestic law as a proper law, there cannot in the juridical nature of things be any question of a claim on the contract arising at international law; the contract is created in and subsists in the local law and it ineluctably follows that it may be terminated in the local law whether by legislation or by some otherwise lawful process.

Maniruzzaman argues that contracts between a State and a transnational corporation for the exploitation of mineral resources situated in the State are governed by public international law. It is therefore contended that the terms of such contract cannot be unilaterally changed by the legislation of the State. They further contend that such a change amounts to a breach of contract. The emergent fact is that the change of itself[1227]or because of the later denial of justice by the domestic system of the State would be a violation of international law.[1228] The methods by which these countries try to exclude the possibility of a choice of law in contracts with foreign investors consist of either requiring a national organisation to assume the legal person of the foreign business enterprise (for example, partnerships or corporations) or stating expressly that the national legal order will govern all disputes.

[1224] See Kuwait Oil Co. Concessionary Agreement, Dec. 23,

[1225] Private International Law

[1226] Another form of internationalisation, less appropriate to developing countries, applies international law or general principles of law whenever that law conflicts with the law of the host country. See A F M Maniruzzaman, 'State Contracts in Contemporary International Law: Monist versus Dualist Controversies' (2001) 12 EJIL 309-328.

[1227] See discussion in A F M Maniruzzaman, 'State Contracts with Aliens: The Question of Unilateral Change by the State in Contemporary International Law' (1992) 9 Journal of International Arbitration 141-171.

[1228] *Ibid.*

The practice of the Federal Republic of Nigeria in granting oil exploration and prospecting licenses and leases provides for arbitration of disputes (except over those matters expressly excluded or said to be at the discretion of the Minister or Commissioner) and states that the lease or license "shall be governed and construed in accordance with the laws of Nigeria and Nigerian law shall be the proper law hereof". Since 1968, all foreign enterprises, whether established in Nigeria before or after 1968, are required to be incorporated under Nigerian Law. This requirement makes all foreign enterprises, enterprises in Nigeria, Nigerian nationals being subject, of course, to Nigerian laws.

The Nigerian Petroleum Decree, 1969, which regulates the oil industry, vests in Nigeria the ownership and control of all petroleum and provides that licenses or leases to explore, prospect and mine petroleum "may be granted only to (a) a citizen of Nigeria, or (b) a company incorporated in Nigeria under the Companies Decree 1968 or any corresponding law. Since only Nigerians can engage in the petroleum industry, it follows that there can be no possibility for a choice of law clause in oil agreements.

The perseverance of the developing countries on the application of their own laws to agreements with foreign investors has been basically aggravated by the directives of the many natural resources producer organisations. For example, the OPEC guidelines for petroleum policy in member countries direct that:

> *Except as otherwise provided for in the legal system of a Member country, all disputes arising between the Government and operators shall fall exclusively within the jurisdiction of the competent national courts or the specialised regional courts, as and when established.*[1229]

A further example is decision 24 of the Andean Commission,[1230] made December 31, 1970, according to which foreign investment agreements by member countries shall not

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[1229] Declaratory policy of the in member countries, OPEC Res. XVI.90.reprinted in (1968) 7 Int'l Legal Mat'l s1183.

[1230] Andean Commission Dec. 24, the Andean Pact Nations – Ecuador, Bolivia, Chile, Colombia, Peru, and Venezuela – declared in Commission Decision 24 that "[n]o instrument concerning foreign investments or transfer of techniques shall include clauses which withdraw possible differences of controversies from the national jurisdiction of the recipient country, or which permit subrogation by the governments of the shares or rights of their national investors". Standard regime for Treatment of Foreign Capitals [sic] and include clauses which "withdraw possible differences or controversies from the national jurisdiction of the beneficiary country."[1231] In view of the fact that in 1966, the several United Nations resolutions on permanent sovereignty of States over their natural resources highlighted the exclusive jurisdiction of local law, these have also been prominent in supporting the developing countries to be resolute that all their agreements with private foreign investors be governed by local law.

Under the positive law, existing State contracts are usually subject to domestic law. Their breach is a breach of domestic law and will not cause the offending State to be wrong-footed when viewed from an international perspective, except in a situation where the breach is followed by a denial of justice in the local courts. As a result of this, a breach of a State contract is therefore not *per se* an internationally unlawful act. It is often the case that those people who conceive it as such are putting forward views *de lege ferenda* and that such views are not desirable on policy grounds.

The policy consideration that is by and large adduced in sustaining such views is that the developing countries need foreign investment, while such investment will not be forthcoming except if it is assured. It has been suggested that the developing countries' acceptance of the international legal character of State contracts will encourage the flow of foreign investment into such countries.

On reflection, however, it should become apparent that the doctrine of internationalisation in this particular form is not the only way by which the protection of the contractual rights of the foreign investor can be realised. Apart from the protection of the foreign investor's rights, there is also the need for a State to retain control over its economy. The fact is that a State may wish to bargain away its regulatory power and this is done by agreeing to the internationalisation of its contract with the foreign investor. The best way of making it equitable is that the domestic law should be developed to achieve fairness to foreign investors and to provide them with as much security as possible within the framework of the domestic law. In other words, the responsibility of public international law should be that of watchdog and, as a result, it

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for Treatment of Marks, Patents, Licenses and Royalties, Andean Comm'n Dec. 24, art. 51(1970), reprinted in (1971) 10 Int'l Legal Mat'ls 152, 166.

[1231] Andean Commission Dec. 24, *Ibid* art 51.

should be able to enforce and develop the supervisory function that it inherently contains.

There are two clear opinions at the extreme ends of this dispute of the law applicable to economic development agreements namely: Some proclaim the application of the domestic law of the contracting State to be appropriate, in order to support the developing host country's position in its relationship with foreign investors and so that the host State shall have the right to modify its contract according to its public interest; while others seek to see entrenched the application of international law in order to internationalise the contract and thus widen the scope of international responsibility in case the contracting State breaches the contract. In listing the advantages of resorting to international law, it has been noted that the State party to the contract and to the litigation, may have no law of contracts, and no commercial law capable of meeting the demands of modern-day trade relations. This argument, however, does not really hold water and should, as a rule, be ignored. This is because most of the developing countries, including Arab countries, have a fully developed legal system of contract and commercial law which could be applicable in the case of contracting parties who do not intend to "delocalise" or "internationalise" their agreements.

It can be concluded that if economic development agreements in general are subject to the domestic law of a contracting state, the contracting country is not the sole judge of the legality of its measures and domestic law is not the only relevant body of law.

There is no denying that the subjugation of economic development agreements to the domestic law of the contracting state is unavoidable. Such law would have to be in accordance with international obligations, or at least such general principles of international law as may be applicable to such agreements until such time as a "Transnational Law" is developed which could be used to resolve the sometimes-complicated problems arising from such agreements. Thus, a contracting State's latitude to take unilateral action with respect to its agreements will not be taken into consideration, since international law will be the legal order within which the domestic law must operate and to which it must conform.

It is submitted that transnational law, already considered as a separate legal system, may contribute to the knotty problems of overcoming the main obstacles to entering into a contract with a government, especially regarding the fear of private foreign investors with respect to a change of law in the contracting country in order to evade its contractual obligations.

Finally, there is a growing recognition that concepts such as the *denial of justice doctrine* and *the minimum standard for the treatment of aliens* can serve as yardsticks of international law by which the standard of the domestic law of a host state can be evaluated.[1232]

6.6 STATE RESPONSIBILITY

In recent modern investment agreements, in addition to the choice of law clause, there is usually a specific commitment on the part of the host country not to alter the terms of the agreement, either by legislation or by any other means without the consent of the other contracting party. The obligations embodied in these clauses create a special stipulation from the viewpoint of State responsibility.[1233]

Many of the rules of State responsibility are known to have originated in the relationship between the United States and Latin America. In fact, early rules of diplomatic protection were formulated in response to circumstances of injuries suffered by US citizens in Latin American countries. Basic underlying principles were sought, and rules of State responsibility arrived at for injuries to aliens are now contained in the body of international law which seeks to enshrine a standard of treatment for aliens who enter states for various reasons including the carrying on of business. However, they create a liability on the host State for failing to observe the prescribed standard in the treatment of aliens.

It is a settled principle of law that an alien who leaves his State carries with him the protection of his State. The theory of State responsibility for injuries to aliens' rests on the idea that an injury to the alien is an injury to his home State. In consequence, resistance of nations on this point in law revolved around the insufficiency of personality

[1232] Date-Bah (n 1019) 249.
[1233] Gracia Amandor 'State Responsibility in the Case of Stabilisation Clauses' (1993) 2 J. Transnat'l L & Pol'y, 23.

in the alien to take up his case in an international debate.[1234] The fiction, however, involved an emphasis on the link of nationality between the alien and his State and the notion of the injury caused to the State through the intermediary of the alien as a result of this link. This was the issue that was deliberated upon in the case of *Peeves v Saldutiskis*[1235] and the Permanent Court of International Justice explained the position of the law in this way: "In taking up the case of one of its nationals, by resorting to diplomatic action or international judicial proceedings on his behalf, a State is in reality asserting its own right to ensure in the person of its national's respect for the rules of international law. This right is necessarily limited to intervention on behalf of its own nationals because in the absence of special agreement, it is the bond of nationality between the State and the individual which alone confers upon it the right of diplomatic protection, and it is as part of the diplomatic protection that the right to take up a claim and to ensure respect for the rules of international law must be envisaged."

Some text writers are of the view that the development of these principles is based on unexceptional sources.[1236] There is general recognition that there is State responsibility for direct wrongs done to aliens. Hitherto, there has been substantial tension caused between developed and developing States as to the application of the rules of State responsibility and diplomatic protection in the area of foreign investment. There is a growing controversy amongst commentators that has principally been focused on the standard of treatment to be accorded to the alien. The developed states have maintained that aliens must be treated according to an international minimum standard, which could be a higher standard than that accorded by the host State to its own nationals.[1237]

[1234] Sornarajah (n 3) 138.
[1235] Panevezys-Saldutiskis Railway Case (1939) Series A/B No.76, 16.
[1236] The basis is that the principles are constructed through 1) Mavrommatis Palestine Concession Case [1929] PCIL series A No. 2, 12, the Court came to the conclusion that a State asserts its own rights when it espouses the cause of its nationals 2) Paneveezys-Saldutiskis Railway Case [1939] series A/B No.76, where the need for the link of nationality between the State and the national whose right was taken up was stressed; and lastly, the Chorzow Factory Case (1928) PCIL series A, No. 17. In this case, the reasoning of the Court was that the restitution as the basis of damages for the wrong done to the national through the violation of treaty rights was reiterated.
[1237] Edwin Borchard, 'The Minimum Standard of Treatment of Aliens' (1940) 38 Mich LR 445; Andreas Roth*, The Minimum Standard of International Law as Applied to Aliens* (Leiden: W Sijthoff 1949).

The subsistence of this minimum standard is asserted in investment treaties. Modern arbitral awards have also recognised that there are minimum standards to which the host State should conform in its treatment of foreign investors.[1238] The minimum standard is an external standard which has enabled developed states to introduce standards of treatment that they expected for their foreign investors but which developing states may find it difficult to satisfy. The failure to conform to the minimum standard of treatment creates a cause of action against the violating State.[1239]

This position was clearly stated in the Neers Claim[1240] and the Roberts Claim.[1241] The formulation in the Neers claim was that to constitute an international delinquency vis-à-vis the national, the treatment of an alien should amount to an outrage, to bad faith, to wilful neglect of duty or to an insufficiency of government action so far short of international standards that every reasonable and impartial man would recognise its insufficiency.

The extension of the idea to the property of the alien was not the focal point of these early cases. Such an extension came much later and became the foundation for building up a law on the protection of foreign investment. Accordingly, a powerful method was created which could be used to exercise influence in the securing of the interests of developed States and their foreign investors. This system, developed in customary practice, is now stated in treaties.

However, some developing countries have maintained that an alien is entitled, at the most, to the same treatment as the citizens of the host State. The glory days of a joint position being adopted by developing countries arrived when the resolutions associated with the New International Economic Order were being debated in the 1970s.[1242] The Charter on Economic Rights and Duties of States was articulated in clear terms.[1243]

Furthermore, subsequent to the decolonisation of the African and Asian States, developed States adopted the view taken by the United States concerning the rule that

[1238] American Machine Tools v Zaire ICSID Rpts 11.
[1239] Sornarajah (n 3) 140.
[1240] *L.F.H. Neer and Pauline Neer (U.S.A.) v. United Mexican States* [The Neer Claim] (1926) 4 RIAA 60.
[1241] *Harry Roberts (U.S.A.) v United Mexican States* [The Roberts Claim] (1926) 4 RIAA 77.
[1242] Sornarajah (n 3) 140.
[1243] Article 2(2) (c) of the charter, which contains, in effect, a restatement of the Calvo doctrine.

there was a minimum standard of treatment for alien property. In the midst of the ending of colonialism, there was a need to ensure that there was a rule-based system of foreign investment protection, because force could no longer be used to settle disputes as in the earlier period. These newly independent states, like the Latin American States, had denied the subsistence of a rule directing a minimum standard of treatment. Asian and African states joined in by contesting the validity of the rule. A number of commentators from developing countries have even questioned the very existence of a law on State responsibility in customary international law.[1244] The most forceful challenges to the perspective of the developed countries have been mounted by the Latin American writers, who contend that the aliens had only the rights and privileges enjoyed by the nationals of the developing country and as a result are only able to seek enforcement of such rights before that country's national courts.

It would seem that the main purpose of the minimum standard rule was the protection of the lives and liberty of aliens in situations of turmoil that occurred in some States or at the hands of corrupt officials. If it had been used exclusively for such purposes, there could have been justification for it, but instead, it became the basis for a system of foreign investment protection which could curb the institution of economic reform by the developing countries.

The Harvard Research Study in International Law on the topic of the Responsibility of States stated that there were numerous cases "where the arbitrary annulment of a contract by the Executive without appeal to the courts was held to justify diplomatic interposition and to render the State responsible."

There is growing support for the position that the legality of a questioned State action may be made to depend upon the issue of whether the State involved is willing to submit such a question to judicial determination. One of the earliest examples is the provision of Article 1 of The Hague Convention (No. 2) respecting the Limitation of the Employment of Force for the Recovery of Contract Debts. This article embodies the so-called Porter Proposition and provides that a State may not use force to recover contract debts owed its nationals by another state unless "the Debtor State refuses or neglects to

[1244] Guha-Roy, 'Is the Law of State Responsibility for Injuries to Aliens a Part of Universal International Law?' (1961) 55 AJLI 863.

reply to an offer of arbitration, or after accepting the offer, prevents any *compromise* from being agreed on, or, after the arbitration, any judicial settlement."

Garcia-Amador, F.V. has suggested that the traditional position must be approached first in the light of modern juridical development. It is evident that the said position was taken with regard to ordinary State contracts and bearing in mind the law governing such contractual relationships. As a result, given the different character of investment agreements and of the obligations contained therein, it is only natural that the traditional position is no longer the right approach to State responsibility. The right view, as far as ordinary contractual relationships are concerned, is that in fact they are exclusively governed by the domestic law of the contracting State, such that a mere breach will not engage the latter in any international responsibility; for international responsibility to come into play, the occurrence of a denial of justice, or of some other wrongful act or arbitrary state conduct, must be required[1245] which then brings to bear a different scenario. If there is a breach of contract to which a government is a party, it is normally the case that in international law no issue of State responsibility can arise unless the foreign national has exhausted his local remedies.[1246] If he is prevented from doing so, or if the court is intimidated or otherwise suborned, the issue is not directly concerned with breach of contract as such, but turns on the extent to which international law can provide a remedy for a denial of justice.[1247] In any event, in the context of a mining concession, this is not generally the contingency against which the foreign investor is concerned to protect himself. As suggested, the contractual obligations of the government may be discharged or modified by an exercise of the

[1245] F V Garcia-Amador, 'State Responsibility in Case of "Stabilization" Clauses' (1993) 2 J.Transnat'l L. & Policy 23.

[1246] States can, and in the context of agreements providing for international arbitration frequently do, waive the rule requiring an aggrieved party to exhaust his local remedies. On the rule generally see Brownlie (n 1134) 482-492; D P O'Connell, *International Law* (2nd edition, London: Stevens 1970) 1053-1059; J E S Fawcett, 'The exhaustion of local remedies: substance or procedure?' (1954) 31 B.Y.I.L. 452-458; C F Amerasinghe, *State Responsibility for Injuries to Aliens* (London: Clarendon Press; Oxford University Press) 169-269.

[1247] Here the term "denial of justice" is used, broadly speaking, in the sense given to it by Art, 9 of the Harvard Draft Convention on State Responsibility for Injury to Aliens – 23 Am. J. Int, Law Special Supplement p. 173 viz. "A State is responsible if an injury to an alien results from a denial of justice. Denial of justice exists when there is a denial, unwarranted delay or obstruction of access to the courts, gross deficiency in the administration of judicial or remedial process, failure to provide those guarantees which are generally considered indispensable to the proper administration of justice or a manifestly unjust judgment. An error of a national court which does not produce manifest injustice is not a denial of justice." The concept of "manifest injustice," of course, gives rise to elusive problems of definition.

legislative competence of the State. If such an event occurs, the contract as originally agreed between the parties no longer exists, and remedies for breach of it may not be strictly in point.[1248]

Another question that readily comes to mind is what the situation will be if the State, by the exercise of its legislative sovereignty, discharges or modifies its contractual obligations. Opinions on this issue are completely divided and what then emerges as decisions of international tribunals on the central point are inconclusive, or open to diverse interpretations.[1249]

Furthermore, in a situation where there is expropriation without payment of appropriate compensation or if the legislation is discriminatory, it then follows that the foreign investor may accordingly invoke the protection of its own State. In the perspective of a mining concession, if laws are enacted which abrogate the concession and terminate the right to mine, it invariably means that expropriation has taken place.

Amongst the circumstances indicating whether such annulment is arbitrary, or, as we have previously defined the issue, whether the termination of a concession agreement by a State is in fact an exercise of a claimed contractual right, is the willingness of such State to submit the issues leading to such termination to arbitration, in violation of an arbitration clause in the concession agreement. This has been held to create international responsibility to the State of the concessionaire.

The right to rely upon arbitration as a means for the solution of difficulties arising out of the contractual relationships of the parties has, among other forces, led to the creation of a type of "living law" of the contract that the parties will, first of all, negotiate in good faith in an effort to resolve their disputes.

[1248] R Brown, 'Choice of Law Provisions in Concessions and Related Contracts' (1976) 39 Modern Law Rev. 625.

[1249]It must be noted, however, that there are no well-settled and generally accepted international rules regarding State measures affecting the contractual rights of aliens. Not only commentators but States and international tribunals as well differ in their views on the law in effect. The fact is that the difference in opinion extends both to *lex lata*, the legal rules held to be effective, and to the *lex ferenda* the law which according to the particular views of each state or person ought to exist. These controversies, far from being merely theoretical disputes, are of real practical importance and have far-reaching effects on the life and relations of nations. See also Fatouros. (n 1173) 244.

When such negotiation fails, then the arbitral process is always available and, usually under the contract, it becomes the duty of the parties to resort to arbitration to settle their difference. The measurement of compensation for nationalised foreign-owned property has been justly called one of the most "intractable issues of contemporary law."[1250] As a starting point it can safely be said that the nationalising State owes some compensation to the foreign investor who suffers the expropriation.[1251] Controversy arises in the attempt to find accepted standards for determining how much compensation the expropriating government should pay. Again, the two opposite positions are represented by classic international law in the form of the Hull Rule,[1252] and the position of Third World nations embodied in article 2(c) of the Charter of Economic Rights and Duties of States, also called the Calvo rule.[1253] The Hull Rule calls for "prompt, adequate and effective" compensation, which means that the investor deserves compensation which takes account not only of the updated value of the physical assets, but also the loss of expected earnings. Another account of the classic position is that the investor should receive the fair market value of its investment.[1254] The developing countries, however, claim that apposite compensation should be calculated on the basis of the net book value, i.e., the value of the assets as registered in the company's books for tax purposes.[1255] There is no denying the fact that most States have not been content to accept compensation for their nationals simply by relying on the Cordell Hull formula requiring States nationalising aliens' property for public purposes and without discrimination to pay prompt, adequate and effective compensation. Some capital exporting countries, particularly the United States, have

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[1250] D R Weigel & B H Weston, 'Valuation Upon the Deprivation of Foreign Enterprise: A Policy-Oriented Approach to the Problem of Compensation Under International Law' in *Valuation of Nationalized Property in International Law* (R. Lillich ed. 1975) 49, 54. [hereinafter cited as Valuation of Nationalized Property];
[1251] M H Muller, 'Compensation for Nationalisation: A North South Dialogue' (1981) 19 Colum. J. Transnat'l L. 35, 37; R Dolzer, 'New Foundation of the Law of Expropriation of Alien Property' (1981), 75 Am. J. Int'l L. 553, 557-58. Professor Dolzer emphasizes the evolution of the rules governing compensation. It may be preferable to distinguish the three aspects of nationalisation (general requirements of international law, contractual relations and compensation). (Only one part of Hull's concept is confirmed, i.e., that compensation must be paid for expropriated alien property as a matter of international law");
[1252] Cordell Hull who was the Secretary of State during the Mexican expropriation of 1938, stated in a letter to his Mexican counterpart, which has come to be the standard ever since. This standard has been espoused by the United Nations and has been referred to as the Hull doctrine of compensation. Dolzer, *ibid* 557-58.
[1253] The doctrine is associated with Carlos Calvo, an eminent Latin American jurist and diplomat.
[1254] The Valuation of Nationalized Property (n 1250) 95.
[1255] Girvan, N. Expropriating the Expropriators: Compensation Criteria from a Third World Viewpoint, in 3 Valuation of Nationalized Property (n 1250).

always discouraged expropriation and, unlike several developing countries, indeed such measures have been accompanied by partial or no compensation, while lump sum compensation agreements have acquired the character of customary international law.

Indisputably, there is no international law compelling a State to allow private foreign investment. Apart from a treaty, there is no right of establishment.[1256] However, once an establishment has taken place, indeed once an investment in a property has been acquired by an alien, if public property requires that that such a property be acquired, then the owner must be paid compensation. Cheng commented:

> *"The rationale of compensation for expropriation consists in the fact that certain individuals in a community, or certain categories of individual, without their being in any way at fault, are being asked to make a sacrifice of their property for the general welfare of the community, when other members of the community are not making corresponding sacrifices. The compensation paid to the owners of the property taken represents precisely the corresponding contribution made by the rest of the community in order to equalise the financial incidence of this taking of private property."*[1257]

The popular view is that in the event of expropriation or the taking of property owned by aliens, various United Nations General Assembly Resolutions on permanent sovereignty over natural resources have reiterated that doubt is cast not only on the obligation of the taking States to pay compensation; these resolutions obviously also support the position that the quantum of compensation is solely within the sovereign jurisdiction of the taking States rather than a matter subject to international legal standards.[1258] On the other hand, some commentators argue that some foreign investors have always maintained that measures unilaterally enacted to provide a better investment climate can easily be unilaterally revoked. Thus, some capital exporting countries have negotiated bilateral treaties for the mutual protection of the national

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[1256] For conditions under which aliens have the right to be acquiring property, see Adeoye A Akinsanya, *The Expropriation of Multinational Property in the Third World*, (New York: Praeger 1980) 191-197.
[1257] B Cheng, 'The Rationale of Compensation for Expropriation' (1959) 44 Grotius Society Transactions 267.
[1258] Adeoye A Akinsanya, Permanent Sovereignty Over Natural Resources and the Future of Foreign Investment' (1979) 5 Nigerian Journal of International Affairs 70-92; Adeoye A Akinsanya, 'The United Nations Charter of Economic Rights and Duties of States' (1980) 30 EGRIL 51-99.

concerned and for recourse to international arbitration, while international measures have been and are being taken to promote and protect direct investment in developing countries.

It would appear that where diplomatic representations or negotiations have failed to resolve investment disputes, there has been recourse to covert or overt intervention to obtain compensation and restore the *status quo ante*. For instance, the United States to a large extent and United Kingdom have actively intervened secretly or openly on behalf of their nationals involved in investment disputes abroad. It is important to note that such intervention could be direct, or proxy intervention as occurred in Iran (1954), Egypt (1956), and Cuba (1961), following expropriations in these countries.[1259]

Furthermore, there have been instances where non-recognition or rupture of diplomatic relations has followed expropriations. Consequently, after the unsuccessful military intervention in the Soviet Union by the Western European powers following large-scale expropriation of private property, the United States of America and a number of countries including Belgium, Holland and Switzerland withheld diplomatic recognition of the Soviet Union. Another case in point is Cuba after the expropriation of most of the properties that were owned by aliens, especially citizens of the United States of America. Further, following much closer cooperation with the Soviet Union, the United States took steps not only to withdraw diplomatic recognition of Cuba but, in January 1961, also terminated diplomatic and consular relationships with that country.[1260] In some other instances, capital-exporting countries, notably the United States and United Kingdom, have taken measures or enacted legislation which they believed would ensure that their nationals would receive "fair treatment" in respect of their acquired rights or assets. These measures included: suspension of bilateral foreign aid programmes in the taking States; denial of trade preferential treatment; blocking or freezing of the assets and bank accounts of the taking States and their nationals in the investor States; and voting against loan applications by the taking States in multilateral financial institutions or State-owned financial institutions.

[1259] Adeoye A Akinsanya, *Multinationals in a changing environment: a study of business-government relations in the Third World* (New York, Praeger 1984) 252-306; it is important to note that Western European States intervened militarily in the former Soviet Union following large scale expropriation of private property by the Bolshevik regime.
[1260] *Ibid* 252-306.

Regrettably, these measures have proved to be ineffective. They have neither deterred nor prevented expropriations, nor have they ensured compensation. In essence, they have been counter-productive. Neither has judicial examination of the validity of foreign expropriations been an effective remedy for obtaining compensation.

Furthermore, the *raison d'être* for international protection in developing countries would appear to be not only because of the damage to the investment climate as a result of a rash of expropriations, revocation of contractual agreements or "creeping" expropriations, but also because measures taken or legislation by investor States aimed at ensuring that their nationals receive "fair treatment" have not, generally, been effective. Some have concluded bilateral agreements with several developing countries for the reciprocal promotion, encouragement and protection of direct foreign investments. Such treaties include specific references to expropriation or compensation for expropriation, "most favoured nation" treatment and settlement of disputes through international arbitration. A typical United States investment promotion and protection treaty provides thus:

> *The prevalent view today would seem to be that a state has a sovereign right to expropriate property within its jurisdiction.*[1261] *There are, however, limits to this right. Clearly, foreign property cannot be expropriated, nor can expropriation be effected in contravention of the terms of the treaty in force.*

Furthermore, it is asserted that there are certain conditions where expropriation can be carried out without any obligation to compensate. The guiding principle would seem to be that such a course of action may only be taken where the concession operates in a manner injurious to the public interest, due to causes outside the contemplation of the State at the time the transaction was entered into.[1262] It may well be that the

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[1261] See the letter of September 1948, from the U.K. Minister in Romania to the minister for Foreign affairs regarding the Romanian expropriation; the famous Middleton letter in the Anglo-Iranian Oil Co. dispute was in a similar vein. The position taken by some text writers is that contractual rights cannot be the subject of expropriations. The prevalent view is that the concession must give rise to acquired property rights and that these may be expropriated.

[1262] The proviso would seem to flow from a dictum in *Czechoslovakia v Radio Corporation of America* that "where a public institution enters into an agreement with a private person or a private company, it must be assumed that the institution has intended by this agreement to benefit its citizens. That this expectation sometimes proves to fail in not giving the country as large a profit as was expected, cannot instrument conceding the concession makes express provision for such a contingency.[1263]

This invariably means that it should be regarded as a matter of termination according to the terms of the agreement and thus not a matter of international law at all.[1264] Yet, where the matter has been one for determination of what is harmful to the public interest, this is mainly the province of the State[1265] save that in neither of these two cases has international law been content to vest an absolute discretion in the State.

It has been suggested, however, that a State could be juridically responsible when it has abused its sovereignty in departing without need from the engagements which it had contracted. This was the view that was canvassed in the Shufeldt case, where the Tribunal argued that the issue of whether a concession was harmful to the national interest was for the government alone to decide, but declined, however, to admit this as conclusive international law and held that if injustice resulted from such decision of the government, the aid of international law could be invoked.[1266] Certain conditions must be satisfied before an act is considered to be harmful to the public interest. The simple fact that a concession is opposed to the commerce of a country,[1267] that the main object of the expropriation is the seeking of a source of pecuniary gain,[1268] or the mere fact that the transaction has not turned out as well as expected do not constitute a yardstick. There are, however, certain grounds that are justifiable. It has been

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be considered sufficient reasons for releasing that public institution from its obligation as signatory of said agreement."

[1263] H G Calvert, 'The Law Applicable to Concessions,' (1959) I.U. Malaya L. Rev. 276. See Art. 22 of the Portuguese law regulating the concession of lands in the Portuguese colonies, which provides that "the State may always avail itself of the provisions of the following clauses if not otherwise expressly stated: The right to expropriate, without any compensation, portions of land required for the construction of works of admitted public utility, roads viaducts, etc."

[1264] This position was demonstrated in the dictum in the matter of the Delagoa Bay Railway Arbitration that "from the moment when they could not justify themselves by the very terms of the concession and when it could no longer be said that the concessionaire was himself responsible, there remained only one principle of law which could be applied to the determination of the compensation to be allowed by this tribunal."

[1265] *Shufeldt v Republic of Guatemala* [1930] Am. JIL 24 799, 814.

[1266] *Ibid*.

[1267] An instructive matter in this regard is that the report of the Transvaal Concession Commission included this as one of the grounds of non-payment of compensation, in cmd. 623, art. 13, pp. 6-8 . This claim was also reiterated in the Persian Tobacco Concession Affair. See Martini *Am. J.I.L.*25 [1931] 554, 562-3.

[1268] United Nations Reports of International Arbitral Award, Vol. I p.7 *et seq.* the expropriations were upheld on the grounds that this was not the object.

suggested that permissible grounds for confiscation would be where, for instance, the execution of the concession is in a manner illegal by the domestic law[1269] or in a manner involving a breach of neutrality. Further, it has also been suggested that when such grants are obtained by fraud, that too will suffice to justify confiscation.[1270]

It is a settled principle of law that fundamental breach of the contract of concession by the individual justifies confiscation. The breach of contract is alleged to result from the fact that the Defendant State whose law governs the contract has, in the exercise of its legislative or executive powers, taken measures particularly designed to terminate or meddle with the particular contract in question. The international tort consists in the confiscatory, discriminatory or arbitrary character of the Defendant State's sovereignty or in short in the *abus de droit* of which it is guilty, and which is sufficient to attract its liability.[1271] A good example arose in the case of the Anglo-Iranian Oil Company. By a concession of 29 April 1933, Persia granted to the Anglo-American company the exclusive right within the territory of the concession to search for and extract petroleum and also to refine or treat in any other manner and render suitable for commerce the petroleum obtained by it. The concession could not be withdrawn or annulled by Persia nor could it be altered. In this case Persia's conduct was tortious because it involved the taking of the alien's property without compensation, or discrimination against the company, or an abuse of rights.

Also, amongst the acts which have at various times been held to amount to sufficient breach to warrant confiscation are failure to commence work within a reasonable time, gross exploitation of affairs, great lapse of time during operations, and failure to conform with an absolute prohibition on assignment.

It would appear that where the breach is non-fundamental, expropriation actually gives rise to an obligation to compensate, taking into consideration a set-off for the

[1269] *Shufeldt v Republic of Guatemala* (n 1265) 814.
[1270] In this instance, compensation was rejected to some shareholders in the Netherlands South Railways on these grounds. This was also the view of the Court in the case of Jarvis Ralston, report (1904).
[1271] F A Mann, 'State Contract and State Responsibility' (1960) 54 *Am. J. Int'l L.* 575.

breach.[1272] It is also the case that where the breach is occasioned by the fault of the State-party, that party cannot be heard to complain of it.

These instances apart, the obligation arising out of an expropriation is to compensate in full, though there is considerable diversity in State practice and otherwise as to the exact measure of this obligation. It is sufficient for present purposes that an obligation to compensate may arise out of the expropriation of concessionary interests.

The Western commentators contend that a lawful expropriation must be non-discriminatory, for a public purpose and accompanied by prompt, adequate and effective compensation. This is the content of international law which is said to be applicable to foreign investment in general and to State contracts in particular. Sometimes described as the "Hull" rule, it represented the international consensus on expropriation until very recently.

U.N. General Assembly Resolution 1803 on the Permanent Sovereignty over National Resources can be considered the Hull rule's most recent collective expression. The challenge from the Third World countries is represented by Article 2 of the U.N. Charter of Economic Rights and Duties of States, which submits all nationalisations to domestic law, without mentioning the public purpose and non-discrimination principles. The principle of compensation, however, is included in the Charter, although there are issues of determination.

Current arbitral practice supports the view that discriminatory expropriations, especially those undertaken for purely political purposes, are unlawful. In B.P. Exploration Co.[1273], the arbitrator employed this standard to declare illegal the Libyan expropriation at issue. In other words, the tribunal concluded that the facts did not evidence discriminatory expropriation, but the principle outlawing discrimination was upheld.

In the Aminoil arbitration,[1274] the company claimed that the nationalisation was discriminatory because the only other foreign oil company operating in Kuwait, the Arabian Oil Company, had not been nationalised. The tribunal rejected this contention,

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[1272] This was the approach that was adopted in the case of Ashmore Fishery, Moore's Arbitrations 1857-9.
[1273] [1974] 53 ILR 297, 326.
[1274] 66 ILR 560-62.

finding that adequate reasons existed for sparing the Arabian Oil Company. By considering Aminoil's argument, however, the tribunal implicitly upheld the principle of non-discrimination as a requisite for nationalisations under international law. At the same time, the tribunal showed great deference toward the government's motives. This attitude probably stemmed from an appreciation of Kuwait's willingness to participate in the arbitral proceedings and the assumption that Kuwait normally would not take actions that would discourage foreign investors. Thus, the arbitral practice indicated that discriminatory expropriations are unlawful, but the host State is not obliged to simultaneously nationalise all competitors within one industry. In practice, the only clearly discriminatory expropriations are those made for political or other extraneous reasons such as revenge, retaliation and xenophobia. However, if the expropriation is otherwise legal, it is not clear whether political motivations would render it illegal.

The tribunal's reasoning illustrates that, even if the public purpose doctrine has survived, in most cases it is very difficult to prove the absence of any public purpose. Thus, in practice terms, the requirement that the expropriation should be in the public interest amounts to the same weakened requirements of the non-discrimination principle: only those expropriations which are unequivocally alien to the general interests whom the government is supposed to represent and protect can be considered unlawful.

Nowadays, expropriation is "the exercise of a jurisdiction, which the state is recognised to possess by international law."[1275] Hitherto, expropriation has been a not uncommon method of meddling with concessionary rights. A dispute arising out of a concessionary relationship is then not unlikely to give rise to the questions (1) is the expropriation effective? (2) What obligations are regarded by international law as arising out of it? And (3) have these obligations been discharged? If, for any reason, the expropriation is futile, then there is an uncomplicated question of breach of contract which is not honestly the concern of international law. If, on the other hand, the expropriation is

[1275] S Friedman, *Expropriation in International Law* (Westport, Conn: Greenwood Press 1981) 204. Any doubt as to the validity of this will certainly raise in itself a matter of inter state law.

effective, there remains the inter-state obligation of compensation for failure to respect acquired rights, a question of international law in the strict sense.[1276]

It would appear that if, in expropriating or nationalising, the result is an unjust enrichment to the State, the interdependency of States reinforces the conclusion that no State shall take advantage of the fact that the resources of another State have entered into its territorial sphere and enrich itself with such resources at the expense of its neighbour.

The rule of unjust enrichment (*enrichissement sans cause*) is one of the general principles of law recognised by civilised nations. This principle is based on the fact that there are situations in which the acquisition by one person of the property interest of another will be generally conceded, in all justice, to require restitution in kind or in value. The existence of this principle and the necessity of its application were recognised in the Laudreau[1277] case involving a guano concession[1278]. Here, the rule in relation to the necessity of reserving rights was deliberated upon by the tribunal but in this case it was found that there was no cause for applying it to the claimant. The Commission stated:

> *Of course if there was anything to show that Celestin knew of this release at the time of its execution and abstained from putting forward his claim, he and his representatives would be estopped from making any claim against the Peruvian Government, but there is nothing to show that there was any such acquiescence in this transaction by Celestin*[1279]

If the act of termination is in the *bona fide* exercise of a claimed contractual right, it is to be deemed an act *jure gestionis* and the rule of exhaustion of local remedies and the requirement of a denial of justice therein applies. On the other hand, if the act of termination is in the exercise of sovereign power independently of contractual right, it is

1276 Calvert (n 1263) 279.
1277 *Laudreau US v Peru* [1922] 1 *Rep. Int. Arb. Awards* 352, at 364.
1278 *Ibid*.
1279 *Ibid*.

an act *jure imperii* of which international law may unswervingly take cognisance and which may be held to be a violation of a right of the state of the concessionaire[1280].

6.7 CONCLUSION

The preferable course for the development of the law in this area should be as follows. The domestic law of host States should be developed to attain fairness to foreign investors, and to provide them with as much security as is possible within the framework of the domestic law. The role of public international law should be that of a watchdog, so to speak. In other words, it should enforce and further develop the supervisory rules that it contains.

If properly restricted renegotiation clauses are stabilisation clauses that differ from real stabilisation clauses by their limited effect of stabilisation in time or with regard to substantive matters, then the issue of contractual stability represents a major source of conflict between transnational companies and host governments. On the one hand, the transnational companies are more concerned with stability and predictability in their contractual relations with the host government, while on the other hand, the host government favours a more flexible contractual regime.

The legal significance of this reasoning is that the host government is not entitled to unilaterally modify or terminate the contract with the transnational corporation. The practical consequence is that the contract cannot be renegotiated or reviewed. The host government counters this argument by relying on the principle of Permanent Sovereignty over Natural Resources and the Charter of Economic Rights and Duties of States under which they claim that these contracts are governed by their domestic laws, and thus subject to unilateral change.

It is submitted that excesses of formalism have failed to properly address the fundamental issues which ought to be addressed, i.e. how changes in circumstances should be dealt with in contracts between transnational companies and host States. It will be contended that a properly drafted renegotiation clause can effectively protect the interests of both the transnational companies and the host governments and,

[1280] Kenneth S Carlston, 'Concession Agreement and Nationalisation' (1958) 52 Am. J., Int'l L., 260.

consequently, thwart any potential conflict. Such clauses are preferable to stabilisation clauses because their flexibility may enable host governments to achieve their objectives.

Lastly, the attitude of Latin American countries towards the ICSID convention and international arbitration has been traditionally articulated in the Calvo doctrine. Firstly, they regard diplomatic protection by an investor as contrary to the sovereignty of the host state, particularly where the investor has bargained away his rights to diplomatic protection in a contract concluded with the host state.

From the aforementioned chapter, the subsequent chapter will investigate the most mutually beneficial contract for both parties; in such a swiftly changing environment, host countries and investors share a special responsibility to strive to negotiate agreements which include (not only for the short run but for the entirety of their term) incentives sufficient to induce both countries and investors to withstand pressures to renegotiate. It should be noted that at this stage an 'ideal' fiscal package (i.e., a fiscal package that the parties have an incentive to adhere to) is a package responding to oil price fluctuations and progressive enough to ensure that the portion of the economic rent allocated to the host country as a 'government take' grows in step with the increases of that rent, while not imposing too heavy a burden on the investor.

CHAPTER SEVEN

THE IDEAL OF MUTUAL BENEFIT

7.1 INTRODUCTION

The topic for analysis in this chapter is whether the activities of the transnational oil companies are mutually beneficial to the host countries. To answer this question, it will be pertinent to examine the international legal obligations of the parties involved. This chapter examines, firstly, the legally imposed obligations enshrined in Article 2 of the African Charter on Human and People's Rights (The Charter). The chapter next examines the situation in the Niger Delta and how it affects the Niger Delta communities and the State of Nigeria in general. Thirdly, the chapter will consider the marginalisation of the oil communities in Niger Delta area of Nigeria, including the injustice of the Land Use Act and the gross abuse of human rights.

Developing countries and transnational corporations are often engaged in long-term agreements which may take the form of concessions, economic development agreements, production sharing contracts, joint ventures, services contracts etc. These agreements could be classified as a species of private contract and therefore be subject to the rules of contract law; it is irrelevant that such transactions are concluded with governments and may involve the exploitation of a national resource or the use of an essential national utility such as electric power or telecommunication. It will be pertinent to examine the bargaining positions of the two parties and the activities of the multinationals.

7.2 BARGAINING POSITIONS OF DEVELOPING COUNTRIES AND MULTINATIONALS

The flow of international investment into the developing countries is one of the most important socio-economic phenomena of contemporary world society and is a phenomenon on which some states have placed confidence in their development planning.[1281] However, some states have also looked askance at the phenomenon and tried, with anecdotal degrees of success, to diminish or do away with its role in the

[1281] Date-Bah (n 1019) 241.

economic development process.[1282] Logically, the most common trepidation amongst developing countries which play host to multinational capital is that the owners of the capital may take over the local economy and as a result may directly or indirectly wield adverse political influence on the local panorama.

Usually, the business of petroleum development entails the use of sizeable risk capital, particularly in the initial stages, sophisticated technology, managerial expertise and marketing outlets. It also involves, to a large extent, negotiation between the multinational oil companies that provide these inputs, on the one hand, and the host country which owns the petroleum resources, on the other. Significant and rapid changes in both the economy and the politics of petroleum and natural resources have forced host governments to adjust both their operations and their objectives. Thus, the corporate objectives of the national oil companies have been very much a moving target. Negotiations often end in the kind of legal arrangement under which the resources are to be developed. In theory, the fact that the two parties have different objectives will provide a basis for adequately safeguarding the interests of each to provide a mutually acceptable basis for cooperation. The law of contract provides such a medium for the parties.[1283] The term "contract" here consists of an exchange of promises, carried out through the process of offer and acceptance, with the element of consideration and the intention to create a legal relationship.[1284] When the contract is made, it binds each party to performance, or, in default, to a liability to pay compensation. This model of contract is inherited from the classical contract law model of the nineteenth century, which is still useful and applicable today.[1285]

Under common law, English courts give relief to a party to an unfair contract. It soon became apparent, however, that the inequality in bargaining power and the resulting unfairness are of different types in different situations. This was the view that was canvassed in the case of National Westminster Plc v Morgan[1286]. Beale explains: "The issue before the court was whether a transaction is or is not unconscionable. This depends, however, upon the facts of each particular case. The underlying fact is that a

[1282] Date-Bah (n 1019) 241.
[1283] Gidado (n 392) 4.
[1284] *Ibid.*
[1285] *Ibid.*
[1286] [1985] 1 ALL E R 821.

contract which is unfair in one case might not necessarily be unfair in another instance, and therefore the category of unfairness should never close. The bargaining power of parties is said to be unequal if the state of affairs is such that one of the parties is so strong in the negotiation process and other so weak that the stronger party is capable of pushing the weaker one into agreeing terms of contract which are in favour of the stronger party. To determine what constitutes stronger or weaker bargaining power, it is pertinent to examine the several doctrines under which the common law gives relief to a party to an unfair contract. This will go towards showing that the inequality of bargaining power and the resulting unfairness are of different types in different cases".[1287]

It has been commented that under English law traditional English doctrines apply only where there is unfairness in the sense of inadequacy of consideration, but the fact is that more modern rulings strike at clauses which leave a party at risk even if value for money has been obtained, and highlight the fact that "inequality of bargaining power can mean ignorance, vulnerability to persuasion, desperate need, lack of bargaining skill or simple lack of influence in the market place".[1288] In the case of Lloyds Bank v Bundy[1289] Lord Denning came to the conclusion that many of the defences to contract enforcement such as duress, undue influence, and breach of fiduciary duty, were appropriately exemplary of a general doctrine of inequality of bargaining power.

According to Beale, "traditional doctrines give relief where a party is in a weak position because of ignorance, inexperience, need or a relationship of trust and the other party has taken advantage of this to make a contract, under which the weaker party is exploited in value for money terms".[1290] He went further that "in the absence of inadequacy of consideration, relief is given by English common law only in very limited situations. The rules on non-necessaries supply to infants on credit protect the infants not just against exploitation, but against the temptation to improvidence".[1291] Subsequently, the core weaknesses are ignorance, inexperience, vulnerability to

[1287] Hugh Beale, 'Inequality of Bargaining Power' (1986) 6(1) Oxford Journal of Legal Studies 123, 125.
[1288] *Ibid* 125. E I Sagey, *Nigerian Law of Contract* (London: Sweet and Maxwell 1985) for the requirements of a valid contract.
[1289] *Lloyds Bank v Bundy* [1974] 3WLR 501.
[1290] Beale (n 1287) 125.
[1291] *Ibid* 123.

influence and need.[1292] Invariably, relief will not be granted unless the other party has exploited the weakness to his advantage, inadequacy of consideration is not in itself a ground for relief but is central to many of the doctrines.[1293]

The topical question is whether such traditional concepts and rules as are applicable to private contracts are admissible in respect of these special arrangements. The main fact is that the classical idea of a contract is a private bargain struck by parties of equal bargaining strength and firmly rooted in the free will of the parties. Asante is of the view that "the judiciary frown at the idea of intervention in contract arrangements and are quite hesitant to declare a contract void as against public policy or to vitiate a contract struck by parties on the grounds that it is in the utmost interest of the social order that men of full age and competent understanding shall have the utmost liberty of contracting, and, based on such finding, that their contracts when entered into freely and voluntarily shall be held sacred and alternatively enforceable by judicial process".[1294]

Another school of thought championed by Professor Horowitz remarks that the modern theory of contract which asserts strongly individualistic idea of contract just referred to was not in place in the eighteenth and nineteenth centuries when jurists attacked equitable concepts of exchange.[1295] Before this time, the courts were of the view that an objective theory of contract obtained, which enabled them to intervene actively to rectify contractual provisions on grounds of equity. The current view is to curb these practices by legislative intervention.[1296] It would appear that there is no immutable doctrine of contracts and that developing countries are perfectly entitled to seek such remedies as fairness and equity in reconsidering contracts that are harmful to the national interest.[1297]

Furthermore, it can be deduced that what amounts to superior bargaining power is ambiguous and varies depending on each case. The fundamental factor is that the contractual transaction is not based on the give-and-take of bargaining but is rather a product of a take-it-or-leave-it-attitude, where the outcomes are seen as what one side

[1292] *Ibid.*
[1293] *Ibid.*
[1294] Asante (n 742) 401.
[1295] M Horowitz, 'The Historical Foundations of Modern Contract Law' (1974) 89 Harvard Law Review 917.
[1296] *Ibid.*
[1297] Asante (n 742) 403.

gains, the other side has necessarily lost.[1298] At the end of the day, the ultimate objective of each of the parties is to maximise short term profits from the exploitation of the resources, despite the consequences of the impact on the other party or project. As a result, the bargaining power could take the form of bargaining skills, sophistication, capital, technology, possession of relevant information, knowledge or the availability of market outlets.

From the analysis of the petroleum development contracts between developing countries and the multinational oil companies has shown the superior strength which the latter have over the former. It would appear that petroleum ventures involve a complex interchange of many matters; ranging from capital economics, to law, politics, development, skills and transfer of technology. The result of any petroleum development contract will greatly depend on the comparative strengths and bargaining positions of the parties in relation to such factors.[1299]

By and large, "the multinational oil companies more often than not have greater bargaining power because of their superiority and access to sources of capital, technological know-how, managerial skills and most importantly marketing channels. The host country, on the other hand, exercises sovereignty over its natural resources to be exploited by the multinational corporations".[1300]

Furthermore, traditional concessions, and typically those contracted before the Second World War, are shown in retrospect to have incorporated terms which were principally beneficial to the companies. Under these concessions, companies acquired large areas, in some cases covering the whole territory of a country, as under the Kuwait concession of 1934 and the Qatar concession of 1935, or nearly half a million square miles as under the Saudi-Arabian concession of 1933).[1301] Companies held ownership of the petroleum that was discovered, appropriated the bulk of the revenues at first paying only a fixed

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[1298] Beale (n 1287) 125.
[1299] Gidado (n 392) 6.
[1300] *Ibid.*
[1301] David Smith, (1973) 'Mining Resources of the Third World: From Concessions to Service Contracts' (1973) *Proceedings of the 67th Annual General Meeting of the American Society for International Agreements* 228.

per ton royalty and exercised virtually total control over all phases of petroleum operations.[1302]

According to Hossain, in bargaining with governments, their negotiating power, frequently supported by that of their home governments, was as strong as that of the host governments was as weak. Governments had no choice but to grant concessions to the major players, on their terms.[1303] The evolution of the relationship between the multinational oil companies and host states is due to alterations in the global environment and the conditions prevailing in the international petroleum industry. These alterations have also resulted in the development of new types of legal arrangements between governments and oil companies, under which governments have been able to obtain the resources of the companies for petroleum development on considerably better terms.[1304]

The revolution of the last few of decades in the terms of concessions has led to the view that "a concession must be seen not as a contract, but as a process in which rights and obligations of both parties shift over periods of time as defined factors change".[1305] Further, bargaining positions can shift owing to changes in the constitutions of the industry, as was the case in the beginning of the sixties, when the entry of a large number of purported "independent" and state-owned companies eroded the supremacy of the major companies which led to competition for acquisition of exploration rights, and therefore enabled governments to acquire improved terms under new types of legal arrangements.[1306]

Shifts in bargaining positions can also take place due to purely local developments. Fabrikant and other text writers commented that alterations in the relative bargaining positions of governments and oil companies result not only from such changes in the

[1302] *Ibid.*
[1303] Hossain (n 259) 59.
[1304] *Ibid.*
[1305] Smith (n 1301) 228.
[1306] Hossain (n 259) 60.

global or the local environment, but from their changing role over the life of a concession from one phase of the operation to another.[1307]

It is important to note that the individual interests of the parties at each stage need to be identified, and it also needs to be understood that the balance of bargaining power shifts during each stage between the government and the company.

There should be no misgivings about that the relative bargaining strength of a company being highest at the initial stages where there are only extensive indications of the prospect of the existence of petroleum resources. For the government at this stage there is an obvious interest in attracting the capital and technology of the oil companies to undertake systematic exploration, involving geological and geophysical surveys, followed by exploratory drilling.[1308] The discovery of petroleum in commercial quantities considerably alters the relative bargaining positions of the parties, in view of the fact that, as has been remarked, the perceived level of risk connected with the enterprise declines at this point in time. The returns to the foreign company no longer seem appropriate to the risk and the Government feels justified in demanding downward adjustments in the investor's share of profits. In the interim, the inclinations of the investor to comply with marginal pressures, if this will maintain the investment, have a propensity to develop.[1309]

At the same time, the enthusiasm and ability of the company "to separate from the undertaking" without first getting back the expected remuneration diminishes as its stake increases through the infusion of equipment, personnel and capital.[1310] Essentially, the comparative weakness of the government position in the initial phase leads companies to focus on negotiating, on the whole, an agreement which secures for themselves the best possible terms in all phases of the operations.[1311]

[1307] Fabrikant (n 611), quoting Louis Wells "A concession contract is the product of a bargaining process reflecting the strengths and weaknesses of the two parties and their bargaining skills. But the relative positions of the parties change with the time…." in *The Evolution of Concession Agreements Economic Development*, Report No. 117, Development Advisory Service Conference, Sorrento.

[1308] *Ibid*; Also, Raymond F Mikesell, *Foreign Investment in the Petroleum and Mineral Industries*, (Baltimore, Md.: Johns Hopkins University Press 2007) 38-39.

[1309] *Ibid.*

[1310] Fabrikant (n 84) 105.

[1311] *Ibid.*

From the government's perspective, it would hypothetically be preferable to negotiate the whole package of terms only after the exploratory work had been concluded and the size of the discovery evaluated.[1312] A company, however, would not be likely to willingly invest in a considerable exploration programme unless it first acquires from the government an agreement or concession that in the event of considerable discovery it would have the right to exploit that discovery and earn sizeable profits.[1313] It is, for that reason, imperative to keep in view the fact that companies endeavour to capitalise on their originally superior bargaining position to secure better terms are absolutely essential in their view.[1314] One such condition would be an agreed legal regime which is cautiously worked out, and which demonstrates an understanding of the dynamics of the petroleum industry and the economics of petroleum development.[1315] This will invariably result in improving the domestic environments in petroleum growth.

To present possible solutions for the introduction of more flexibility in contractual terms in order to 'tailor' those terms to the actual profitability of petroleum operations, and therefore to try to achieve a fair and reasonable sharing of profits between the government and the oil companies, whatever the oil market situation, there are several contractual concepts used around the world by governments to permit international oil companies to carry out petroleum exploration operations and, in the event of a commercial discovery, development and production operations.[1316] The "type of contract selected by a government and the terms and conditions agreed between the signing parties depend mainly on the government policy and the relative bargaining strengths of host countries, which are directly linked to the petroleum potential of the offered acreage and the international oil market situation".[1317]

In any agreement, "the package of economic and fiscal provisions, known as the 'fiscal package', plays a central role, since this constitutes the mechanism which enables the allocation of economic benefits and risks between the parties concerned. The

[1312] Roland Brown and Mike Faber, *Some Policy and Legal Issues affecting Mining Legislation and Agreements in African Commonwealth Countries*, (London: Commonwealth Secretariat 1977) 10.
[1313] *Ibid 10.*
[1314] *Ibid.*
[1315] *Ibid.*
[1316] Honore Le Leuch, 'Contractual flexibility in new petroleum investment contracts' in Nicky Beredjick, Thomas W Walde and Ian Townsend (eds), *Petroleum Investment Polices in Developing Countries* (Springer Science & Business Media 1988) 81.
[1317] *Ibid.*

international oil market situation and its impact on petroleum prices need to be carefully considered".[1318] In the late 1970s, as a consequence of the increase in crude oil prices and the strong competition among oil companies to conclude new agreements, there had been a general tightening of contractual terms which showed in higher 'government takes'.[1319] Conversely, "since 1982, a tendency to grant incentives to oil companies to attract exploration capital has made itself felt, because of the 'glut' and falling prices in the international oil market".[1320]

In such a swiftly changing environment, host countries and investors share a unique obligation to negotiate agreements that are beneficial for both long and short term objectives. It is worth noting that the 'ideal' fiscal package is one which is responsive to oil price fluctuations, whilst ensuring that the host country's economic rent grows accordingly without imposing unnecessary burdens on the investor.

7.3 GOVERNMENT OBJECTIVES

It is worth bearing in mind that energy is the main factor for development and its presence or absence within a country always has a remarkable effect on that country's level of development. As a result, all countries are keen to ensure that they have access at all times to sufficient energy resources to meet their needs. For instance, during the previous U.S. Administration, as a result of the soaring petroleum prices in the world market, President George W Bush threatened to stop buying oil if the prices continued going up. Ever since the early part of this century, petroleum has been the most multifaceted and economic energy source. Apart from this, it has many derivatives and end users which make it an essential component for many industrial processes. It is for that reason that oil is the most important globally traded commodity today.

Furthermore, the need for petroleum leads to the employment of different strategies by various countries, principally dependent on whether they are developed or developing, importers or exporters. The developed countries are mainly importers and place a lot of emphasis on ensuring security of supplies and not being dependent on any one source. They are also concerned with increasing, or at least maintaining, their reserve levels.

[1318] *Ibid* 82.
[1319] *Ibid.*
[1320] *Ibid.*

On the other hand, those developing countries who need to import oil are the poorest countries of the world. Unlike the richer importers, they cannot afford to spend what they do to meet their annual energy need.[1321] To reduce the effects of the oil deficit on their balance of payments, their only hope is for petroleum to be discovered in their territory. For this reason, it is also particularly important for exploration programmes to be conducted within their territories. The oil exporting developing countries are more fortunate. However, the main difference between them and their poorer counterparts lies in the presence of large deposits of petroleum within their territory.[1322] These countries have other important needs, such as to ensure effective control over their petroleum resources, and to maximise the revenues accruing. It is nevertheless just as important for them to ensure that exploration efforts are increased rather than decline, and to maintain their leading position through continuous increases in reserves. [1323]

The main objective for all countries, but predominantly for developing countries, is thus to ensure that exploration programmes are started and regularly continued in their territories.

This retention of revenue is identifiable as a second objective. The revenues retained by the state are or should be used to realise the policy objectives of the particular state, and to ensure that the activities of the oil industry complement these policy objectives.[1324]

The third objective is thus to ensure that oil industry activities complement and aid the stated policies of the country in question. This is the objective of ensuring control over petroleum resources.[1325]

This objective came to the fore in the 1970s, which was both the period of the oil boom and of permanent sovereignty over natural resources. For some years now, less and less is being heard about control of petroleum resources, because this is only possible during a boom period when the host country is in a stronger bargaining position. However, the issue does not vanish completely, it only ebbs into the distance. Certainly, it cannot

[1321] *Ibid.*
[1322] *Ibid.*
[1323] *Ibid.*
[1324] *Ibid.*
[1325] *Ibid.*

vanish, because it is only when a country controls its oil industry that it can actually successfully ensure that the other three objectives are accomplished, and that any profits accruing through the industry are properly deployed in the furtherance of national development.

It will be seen that all these objectives have as their basis the entrenched desire of all nations to be economically independent, and to be free of foreign domination. Early concession agreements were concluded within the colonial era and were invariably lopsided in the company's favour with the companies being given "such grotesquely favourable terms as could hardly survive the collapse of colonialism."[1326] In addition, these agreements were possible because of the lack of knowledge and expertise by the host country.

Although most exporting countries are generally concerned in preserving absolute control over petroleum operations and the growth of the nation's revenues accrued, oil importing countries are keen to promote cooperation with oil companies, with a view to reduce the effect of oil deficit on their balance payments.[1327] Furthermore, due to declining revenues and dwindling resources, exporting countries "are looking at promoting exploration to find new discoveries and encouraging development of marginal discoveries". As such, a balance must be achieved between various governmental petroleum policy objectives:

- *To stimulate exploration activities through incentives given to the exploration risk-takers;*
- *In case of production, to maximise national revenue from petroleum, to achieve a fair government take in petroleum profits without discouraging investment from foreign oil companies;*
- *To maintain national control over resources;*

[1326] Asante (n 4) 244.
[1327] Le Leuch (n 1316) 81.

- *To develop national technology and expertise (transfer of technology, training, actual involvement of nationals in petroleum operations, preference given to local equipment and domestic service companies);*
- *To minimise the nation's financial risk in exploration activities, risk capital being provided by international oil companies.*[1328]

International oil companies are primarily concerned with the following three objectives rather than by the type of agreement itself:

- *To achieve a reasonable return on their investment, taking into account the exploitation risks and the long lead time between the exploration and the exploitation. The probable rate of return of a new venture has to be competitive with other investment opportunities available to the company in other countries, especially in countries which are already producing (whether they be developed or developing countries);*
- *To enjoy an acceptable pay-out time in which to recover their original investment;*
- *To gain long-term access to new supplies of crude oil or natural gas, through the right to export a significant part of the production.*[1329]

Further, it is worth recognising that, irrespective of the type of contract, oil companies are limited to "petroleum agreements containing provisions considered as standard in the international oil industry in terms of foreign exchange procedures, control of management of operations, sanctity of contracts".[1330]

Notwithstanding, Le Leuch emphasises on the mutual compromise both parties must be willing to make. He explains that "for a country deciding to promote petroleum activities, contractual terms have to be designed in order to encourage the participation of international oil companies willing to quickly commit meaningful exploration budgets, while safeguarding the country's long-term interest".[1331]

[1328] *Ibid*.
[1329] *Ibid* 82-83.
[1330] *Ibid.*
[1331] *Ibid.*

7.4 GOVERNMENT AND OIL COMPANIES' RELATIONSHIPS: OBLIGATIONS

In Nigeria, crude oil is the bastion of the economy. What takes place with regard to crude oil plays a considerable part in deciding the fortunes and misfortunes of the country in several ways:

- First of all, the supremacy of oil in the economy has turned the country into a voracious rentier state, i.e. a rent-seeking entity in quest of maximising the gains from oil revenues at all costs.
- Secondly, the importance of oil revenues has lit-up the possibilities for corruption. Within the Federal Government as the major gatekeeper for oil revenues, the centre has essentially become the main objective of an intensive zero-sum game between and among various factions of the ruling classes, military and civilian alike. Furthermore, oil revenue has led to the formation of a convoluted and mainly unofficial patron-client structure of incentives, promising astounding affluence to those in charge of political power. These concentrations of power in the hands of a few elites who socialise around the corridors of power more or less without end encourage political corruption and the unjustifiable abuse of power.
- Thirdly, being a classical oil rent economy, economic development is strongly tied to sustaining and escalating oil earnings; a situation which requires the government to go to any lengths to secure this accumulative base.[1332]
- Lastly, the possession of oil has enforced the absolute integration of Nigeria into the mayhem of global economy in a manner that has often taken the wind out of its sails as regards the country's developmental ambitions.

This oh-so-frequently 'unholy' association between the drive to maximise oil revenues and the detrimental effects on the country's real development needs operates whether the brokers of oil business are the duly representative national bureaucrats or whether they are wielders of unauthorised power. What it boils down to, either way, is basically the same thing in terms of the multiplier effects of promoting a mutually valuable

[1332] Sayre P Schatz, 'Pirate capitalism and the Inert Economy of Nigeria' (1984) 22(1) Journal of Modern African Studies 45-57.

political and economic relationship between the State and multinational oil companies to the exclusion of oil communities.[1333] In most instances, moreover, such coalitions have served multinational oil companies far better than the government. It should be recalled, for a case in point, that "during the depressing and ignominious days of military rule in Nigeria, multinational oil companies were amongst the few overtly flaunting their predilection for such 'stable' regimes instead of an 'unhinged' democracy".[1334] Ultimately, this relationship is at the heart of the persistent violence and political disaffection which has followed the allegations by minority oil communities of domination, socio-economic marginalisation and segregation, and the colossal damage to their environment by multinational oil companies.[1335]

As is already stated in this study, prior to 1971, oil companies operating in Nigeria enjoyed oil concessions on very favourable terms. The concession era ended in 1969 with a new Petroleum Act that gave the Federal Government greater control of the industry. Subsequent to 1971, *the government progressively increased its participation and regulation of the oil industry by creating partnerships with private foreign investors through a range of joint venture agreements, risk service contracts and production sharing agreements".[1336] From that time also, the government wanted to transform its role from that of a mere collector of oil taxes and royalties to that of an active participant in the oil industry.[1337] It should also be noted that such increasing government intervention and involvement in the oil industry was in large measure motivated by the need to grant developing native elites more scope in deference to foreign capital, as dictated by the indigenisation policy of the government at that time.[1338]

Hitherto gain leverage with multinational oil companies, the government transferred rent and royalties from offshore petroleum wells of the producing states concerned. By

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1333 Eyinla and Ukpo (n 894) 25.

1334 Charles Ukeje, *A Farewell to Innocence? African Youth in the Age of Globalization* (2004) Mary Kingsley Zochonis Lecture of the Royal Africa Society to the Forty-first Annual General Meeting of the African Studies Association held at Goldsmith College, University of London, UK.

1335 Eyinla and Ukpo (n 894) 25.

1336 Olukayode Soremekun and Cyril Obi, 'Changing Patterns of Foreign Investment in the Nigerian Oil Industry' (1993) African Development, XVIII(3) 5-20; Ian Gary and Terry Lynn Karl *Bottom of the Barrel: Africa's oil boom and the poor* (Baltimore, MD: Catholic Relief Services 2003).

1337 Eyinla and Ukpo (n 894) 26.

1338 *Ibid.*

April 1977, the Nigerian National Oil Corporation and the Ministry of Petroleum Resources were subsumed into the NNPC, which became the sole government agency for control and regulation of the oil industry.[1339] The Department of Petroleum Resources (DPR)[1340] was also "created to further ensure effective regulation of the oil industry, enforce compliance with industry regulations, process applications for licenses, and to enforce environmental regulations by multinational and local oil companies, but still allowing multinational oil companies to wield and enjoy a lot of economic and political influence".[1341] Eyinla and Ukpo contend that notwithstanding the quest for control, "the government could neither challenge nor gain leverage over the technical capabilities of multinational oil companies".[1342]

It has been asserted that government agencies, and especially the NNPC, expected to standardise and control the industry. This may also be part of the problem, taking into consideration its over-bloated bureaucracy.[1343] Those who have made such assertions also point to the absolute incompetence of its financial and audit control mechanisms, the persistent mismanagement and corruption taking place inside and around the organisation and the fact that the company performs more like a mini-state surrounded by the larger state.[1344]

Furthermore, "multinational oil companies operating in Nigeria have come to resemble the proverbial cat with nine lives"[1345] because of their obvious elasticity and flexibility in continually re-engineering their supremacy of the sector, through gaining apparent government agreement to the sorts of terms and conditions which obtained under the same joint ventures, PSAs and other arrangements[1346]. As regards the prospects for the private local oil companies, it is also obvious that the granting of more opportunities to such companies is unlikely to modify the existing control enjoyed by foreign oil

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[1339] *Ibid.*
[1340] The DPR is entrusted with faithfully monitoring, on regular basis, the activities and facilities of oil companies and ensuring strict compliance with all governing laws, regulations and guidelines for optimum safety. Results of such monitoring and supervisory activities need to be published.
[1341] Eyinla and Ukpo (n 894) 26.
[1342] *Ibid.*
[1343] *Ibid* 27; One good thing is that, in recent times, the NNPC has been making genuine efforts to address this situation by downsizing its work force.
[1344] *Ibid.*
[1345] *Ibid.*
[1346] *Ibid.*

companies, given that the private local companies more often than not still depend on capital and technical expertise from abroad.[1347] It is shameful that after nearly six decades of oil production, Nigeria is unable to develop its resources without assistance from external multinationals.

This dependency on multinationals undermines the practicality of the government to institute effective control on the industry. The host government, as essentially bystanders in the development of their own resources, has led to discord with the multinationals. Eyinla and Ukpo highlight that "even on very straightforward matters – including those such as the exact quantum of crude oil produced, and revenue derived – government has had to accept without due challenge the judgment and claims of multinational oil companies".[1348] The country's economic dependence on the exportation of these resources has only fuelled the government to agree to favourable investment incentives in the oil industry. Eyinla and Ukpo conclude that "fiscal and budgetary decisions are pegged to crude oil revenues, the unpredictability of oil prices in the international market tends more to emphasise than improve the problem of planning in Nigeria".[1349]

In view of the incidence of corruption and obnoxious practices in Nigeria, balance sheet discrepancies have occurred intermittently on production and oil revenue receipts between multinational oil companies and government. Notably, even though it is able "to obtain specialised skills and expertise to maintain an effective audit trail on real oil production, lifting and sale, some of the government's own practices, including that of maintaining an out-and-out account for a percentage of oil proceeds to fund particular projects, are open to excessive abuse".[1350] Such abuses have been the basis of recurrent and unnecessary extra-budgetary expenditures that have been disparaged many times over.

An additional factor is the failure of government to manage petroleum revenue in a transparent way. Such discrepancies fuel public concern that government may in reality

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[1347] *Ibid.*
[1348] *Ibid.*
[1349] *Ibid.*
[1350] *Ibid* 28.

be obtaining less than the revenue declared from crude oil sales.[1351] Cutting the potential for sharp practices may be easier said than done, as it may not be practical for government to guard against such practices due to its own intrinsic technical and institutional limitations.[1352] The fact is that assertions that multinational oil companies may be short-changing the country are not new.[1353] For example, as far back as 1969, the then Minster of Finance, Chief Obafemi Awolowo raised this concern. Soon thereafter, the Government began exploring ways to secure greater participation in the industry. One of the key steps in doing so, was to abandon the 1914 Petroleum Act which it inherited from the colonial government and forestalled such active involvement.

Furthermore, multinationals operating in Nigeria often acquire a quasi-governmental role in the industry, leaving them as largely unaccountable corporations. It is generally the case that oil revenues will translate into colossal advantages and prospects to the political elite, which subsequently leads to resentment from the masses. It is hardly surprising that uprisings against the government are frequent in oil producing regions. In order to bridge the differences between the masses and the government, multinationals are left with no choice but to balance a quasi-governmental role alongside their commercial interests.

7.5 DUTY CONCERNING HUMAN RIGHTS

The movement for human rights has been paralleled in the area of environmental protection, although much soft law which exists there has been found to be wanting.

There is a growing literature on the obligation of corporations to stand up for the standard of human rights in the line of their actions in the host state.[1354] These responsibilities include a duty not to uphold a regime which abuses human rights in the host state, mostly in situations in which such abuse works to the benefit of the transnational venture.

[1351] *Ibid.*

[1352] *Ibid.*

[1353] *Ibid.*

[1354] M K Addo (ed) *Human Rights Standards and the Responsibility of the Transnational Corporation* (The Hague: Kluwer 1999); and Nicola Jaeger, *Corporate Human Rights Obligations: in search of accountability (*Mortsel, Belgium: Intersentia Publishers 2002).

The behind-the-scenes activities of multinational oil companies tend to negatively influence political issues, including human rights violations and environmental degradation, and more significantly, weak or non-existent enforcement on requisite industry laws and regulations. Amongst oil multinationals, the belief is that they are not under any legal obligation to concern themselves with the gross human rights violations around their areas of operation. They shut their eyes to the 'social contract' obligations of corporate entities to see themselves as moral agents with commitments and responsibilities to host communities.[1355] As a result of this apparent attitude, they are also ultimately advancing oppression and contributing to the violation of human rights in host communities. One of the areas to which this obviously relates would be labour standards, which have traditionally been focussed primarily on ensuring the availability of a ready and servile pool of cheap labour to the foreign multinational corporation. The movement in this sphere by the International Labour Organisation has been useful in bringing about instruments which address the matter of possible safeguards to protect workers from abuse by Multinational Corporations.[1356]

Additionally, carrying great weight are the modus operandi in the area of human rights that have brought about sanctions against abusive practices against both workers as well as people who are affected by the activities of multinational corporations.[1357] For example, in the case of the Niger delta area of Nigeria, the local inhabitants, dissatisfied with the status quo, have been agitating for a return to local control of mineral resources.[1358] These sentiments motivated the Ijaws, along with other ethnic tribes, to issue the Kaiama Declaration in 1999 demanding control of the oil in their land.[1359] They have further articulated their demands in similar documents. The meeting of such demands would require sweeping constitutional changes. Short of such changes, the only option open to local communities is litigation. Interviews with community leaders

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[1355] *Ibid.*

[1356] The question of whether such labour standards should form part of the multinational code of conduct on investment has been the subject of consideration for some time now. See Lance Compa, 'The Multilateral Agreement on Investment and International Labour Rights. A Failed. Connection' (1998) 31 Cornell Int'l L.J. 683.

[1357] M Sornarajah, *The Settlement of Foreign Investment Disputes* (The Hague: Kluwer International 2000) 175.

[1358] *Ibid.*

[1359] *Ibid*

and activist groups reveals a general lack of awareness of the value and efficacy of court action.[1360]

At the same time, many activists and leaders display little confidence in the ability of the current court system to assist them. They claim that oil companies frequently respond to litigation with incessant, unending appeals, making certain that the litigants, even if they have succeeded in their claims, do not benefit from their legal victory.[1361]

In addition, the cost of bringing a case against the government or oil companies renders this prospect impossible for many individuals and communities; the right to private enforcement of environmental laws is almost non-existent in Nigeria. Until some mechanism for financially supporting environmental and human rights litigation is put in place, cost will continue to elude many Nigerians from exercising their rights.[1362] The conflicts outlined above indicate that the development of human rights in Nigeria, whilst accelerated by the democratic dispensation, remains obstructed by a number of institutional stumbling blocks. In some areas, such labour rights, definite gains have been made. According to labour leaders, companies like Chevron are beginning to recognise oil industry unions after decades of opposing or ignoring their existence. Industry practices promoting safety have improved, pay is considerably higher than the national average, and prohibitions on international labour associations have been lifted.[1363] On the whole, however, Nigerians living in oil producing regions still struggle, sometimes dangerously and often fruitlessly, to have their basic human rights respected. What is more, even as human rights gain wider acceptance in Nigeria, a

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[1360] *Ibid*; There are signs that this may be changing. Since being interviewed for this report, a Nigerian environmental rights group, the Community Rights Initiative, has decided to employ litigation as a tool for environmental protection.

[1361] Interview with Joi Yowika, attorney for several oil-production communities, September 1999.

[1362] One option that may prove useful is attempts by community members to seek redress in the Human Rights Panel set up by the past government of Mr. Olusegun Obasanjo, Joi Yowika, who represents the Ogonis, notes that they have filed over 5,000 petitions regarding human rights abuses. The panel headed by retired Supreme Court Justice Chukwudifu Oputa, has no sanctioning or enforcement powers, but its decisions are likely to bear some weight in determining the government's position on past human rights abuses.

[1363] Interview with Joseph Akinlaja, Secretary-General of the National Union of Petroleum and Natural Gas Workers (NUPENG). September 1999. Mr. Akinlaja lost his job at British Petroleum (later renamed African Petroleum) for leading a demonstration. Oil companies now solicit input from unions before making decisions that impact on workers and have made other improvements, such as distributing safety kits and undated manuals. Until recently, Nigerian law and the constitution of the umbrella organisation of the trade unions, the Nigerian Labour Congress (LNC), prohibited associations with unions in other countries; these prohibitions have now been lifted and NUPENG is in the process of joining ICEM, an international association of unions for workers in the chemical industry.

more enduring aspect of Nigeria's oil legacy threatens people living in oil producing regions: the degradation of natural resources vital for life.[1364]

Under U.S. law, there is an old statute, the Alien Tort Claims Act, which makes any act considered a tort in international law actionable in the U.S. courts. There are ample numbers of cases in this area of law and the U.S. courts have not denied litigation on the grounds that the acts complained of are extraterritorial. This was the issue that was deliberated upon in the case of Doe v Unocal.[1365] In this case, the allegation was that a U.S. multinational corporation had participated actively or passively in the torture, forced labour and the killings of the aboriginal people by the Burmese military agents in the land through which the gas pipeline it was constructing for the Burmese government passed.[1366] The focus shifted to the liability of the multinational corporation for being a knowing participant in the alleged activity.[1367] The courts have progressively held that there is a foundation for jurisdiction, though none of them has hitherto gone on to hold that there could be a legal responsibility. The connection to the parent company in all these circumstances is that the parent company has managerial control and for that reason had legal responsibility for the acts of the subsidiary in the host state in which the human violation was being committed.[1368] The underlying fact is that the Aliens Tort Act which has facilitated the instituting of such jurisdiction, is not superfluous to the pursuing of the policy behind such litigation.[1369] The moral rationalisation is provided by the fact that the parent corporation benefits from the fault of its subsidiaries in the state and should, as a result, accept the blame for these faults[1370]

There exist, however, a legion of cases connecting the involvement of multinationals with past crimes, and there is a common consensus towards legal responsibility. There are instances where Jewish plaintiffs have made claims against a number of U.S. corporations based on the allegation that these corporations had helped the Nazi government by the provision of technology and other forms of assistance which were

[1364] Environmental & Planning Law Review (2005) 2(2) EPLR 3 ISSN; 1597-4553 131.
[1365] 960 F Supp 660 (1997) (CD Cal); there is a barrage of cases that have extensively treated this issue. For instance *Saro-Wiwa v Shell*, 226 F 3d 88 (2000) (2nd Cir); Sornarajah (n 1357).
[1366] Doe v Unocal 960 F Supp 660 (1997) (CD Cal)
[1367] *Ibid.*
[1368] *Ibid.*
[1369] Sornarajah (n 1357) 177.
[1370] Beth Stephens, 'The Amorality of Profit: Transnational Corporations and Human Rights' (2002) 20 Berkeley JIL 45.

instrumental in the extermination of the Jews.[1371] Even banks have not been excluded from such crimes and as a result they are subject to claims on this basis.[1372] There are very many cases which establish universal jurisdiction over gross human rights violations such as torture and genocide which can be brought to reinforce the endorsement of such jurisdiction over the parent corporation.[1373] It is pertinent to note that this development is not peculiar to the U.S. This is also the view in England and other jurisdictions like Australia.[1374] For instance, the law of England recognises jurisdiction in the parent company in respect of asbestosis-related disease occurring in a worker in the Rhodesia operations of a subsidiary.[1375] On the other hand, courts have frowned and, as a rule, even where they may have been on the verge of imposing legal responsibility, often withdrawn by finding a want of jurisdiction. Matters are treated as non-permissible on the basis that finding jurisdiction over corporations on the basis of their sheer presence abroad may put foreign interests at risk.[1376] There is a growing recognition that where there is involvement by a multinational corporation in such crimes, reliability will be lost if courts allow the argument that national interests countervail the need to accord legal responsibility to the offending entities.

Also, there are in existence some soft law prescriptions relating to the obligation of multinational corporations to respect human rights. It is a growing area of law, and these prescriptions do not have much effect.[1377] Sometimes there is an attempt to show that some progress is being made towards conforming with the essential matters.

[1371] Sornarajah (n 1357) 177.

[1372] *Ibid.*

[1373] A classical case, the *Pinochet case* (1999) 10 EJIL237, is instructive in this regard. The judgment of Lord Millet argues forcefully that there should be jurisdiction in situations of torture, even in cases of the absence of any law within the domestic law incorporating conformist norms preventing torture.

[1374] Dagi v BHP [1997] 1VR428. BHP sued in tort for polluting Ok Tedi River and the adjacent land, thus prejudicing the plaintiffs' enjoyment of the land and waters, which involved the tailing from a gold/copper mine. The court stressed the issue of negligent management of the multinational's activities on the basis of human rights violations and environmental degradation. This case was an effort to bridge the yearning gap of holding multinationals accountable for the adverse consequences resulting from their operations. See also the more recent case of Chandler v Cape [2012] EWCA Civ 525.

[1375] *Cape v Lubbe* [2001] 1 WLR 1545.

[1376] In the case of *Sarei v Rio Tinto*, 221 221 F supp 2d 1116(CD Cal 2002), jurisdiction was accordingly refused.

[1377] Sornarajah (n 1357) 174.

7.6 OBLIGATION NOT TO MEDDLE IN DOMESTIC POLITICS:

The common practice is that multinational corporations operate in host states in such a way as to make certain that governments or groups favourable to the multinational company hold on to power. Repeatedly the charge is that the "multinational corporation holds a proxy on behalf of the home state to ensure that there is flexible government or that the home state encourages meddling to ensure that pro-business governments are elected". [1378]

In recent years, many systems have been put in place to ensure that the multinational corporations do not meddle in the politics of the host state. The statements contained in these are usually soft law interdictions. However, the question arises in modern law as to "whether there is a more direct responsibility in a state of affairs in which there is a connection of the Multinational Corporation or associated home state officials for effecting coups or carrying out regime change in the host state governments",[1379] since such an alteration in government will favour the multinational corporation's actions or favour the home state's strategies and objectives. The assessment of progress in establishing such direct personal liability of the corporations or officers for such action is an area which remains to be completely investigated.[1380]

Further, in the light of developing realities, multinational industries can no longer afford to be complacent in view of the challenges posed to the future of the industry.[1381] The preventive approach and the case by case approach to environmental and human rights issues are no longer adequate. As a developing phenomenon, this study concurs with the International Association of Geophysical Contractors[1382] that the successful management of human rights and the environment requires planning, training, consultation and evaluation.[1383] The evaluation of the human rights report on the Niger Delta State would empower the industry to make erudite decisions about operations and

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[1378] *Ibid.*
[1379] *Ibid* 174.
[1380] The classic example is the *Pinochet case*; there is no consensus amongst commentators as to the extent of legal responsibility for effecting changes of foreign governments. Time will tell.
[1381] CPMLP Journal, "Environmental and Human Rights Issues: Implications for Petroleum and Mineral Investment" CPMLP Website (2001) 29.
[1382] *Ibid.*
[1383] *Ibid.*

to determine its activities with potential environmental and human rights impact.[1384] In the case where the impact is foreseeable, it permits the oil industry to make apposite venture decisions, as to whether taking into consideration the probable threats and the alleviation of costs it would be cost-effectively useful for a project to go ahead or not. In addition, the industry should always be resolute on environmental and human rights impact assessments for every project, irrespective of whether provided for or under the national law of the host countries.[1385]

In the course of their links with the security arms of the state, multinational corporations progressively turn their areas of operation into garrisoned enclaves. Thus, the host country may be concerned about its military security.[1386] Vagts explains this dilemma, in which he explains: "the product of the multinational corporation may be critical, directly or indirectly, to the defence structure of the state; local production may seem vital. Still, to allow production to be carried on within a structure which is controlled by a foreign commercial organisation and which ultimately owes some, if not primary, allegiance to a foreign political entity is to vitiate that security. The United States which has twice panicked over the power of the German chemical industry in this country,[1387] can hardly tell other nations that this concern is a mirage".[1388]

Furthermore, the activities of multinationals in extractive industries "tend to excite great anxieties in host governments and in the popular imagination, giving rise to visions of a country stripped of its natural heritage, like Peru after the Conquistadores, while the benefits have fled abroad. Some multinational corporations have disturbed host governments more than small firms might because of the scale of their production, their tendency to exclude rival producers and their capacity to integrate downstream activities in a way that arouses suspicion that they are avoiding national policies. It should be noted that it is this latter aspect that converts a simple large-scale mining or drilling

[1384] *Ibid.*
[1385] M Zahraa and A Shehu, 'Environmentalism versus Oil: Nationalism in the Niger Delta. Current Concerns and Dilemmas of the Multinational Oil Company' (2006) 4(3) OGEL 1-29.
[1386] Note, for example, the French concern over the United States denial of use of the IBM computers in connection with atomic testing, reported in John Walsh, 'France: First the Bomb, then the 'Plan Calcul' (1967) 156 Science 767.
[1387] Hearing on 3rd Res. before the Senate committee investigating the National Defence Program 77th congress (1941).
[1388] Detlev F Vagts, 'The Multinational Enterprise: A New Challenge for Transnational Law' (1970) 83(4) Harvard Law Review 739, 761.

operation into a transnational enterprise with its special aspects of integrated international operations and product diversity".[1389]

Accusing fingers have been pointed in the direction of multinational oil companies for providing logistical and infrastructural support to the coercive arms of government, including the military and the police, in return for 'protection'.[1390] According to Ukeje, it is not totally unplanned that many police stations and military posts are located close to, next to, or inside oil installations.[1391] This explicitly shows that as far as the oil region is concerned, the infrastructure of oil and oppression are closely linked in such a way that power flows from both the barrel of crude oil and the barrel of a gun.

The hostility between multinational companies and host governments has, to some extent, broken in recent times. In an era where communism has been shown to be ineffective and the dominance of a free market economy to organise the means of production is gaining acceptance, hypotheses which are antagonistic to private schemes as the means of producing growth are unlikely to make progress.[1392] "In the midst of the increasing privatisation of state companies underway in developed countries as well as developing countries, and the progress of the capital markets in most developing countries, there has been a significant shift away from ideological opposition towards foreign investment". Several states have seen more wisdom in a practical approach to the quandary than in a specific ideological posture.[1393] The fear that multinationals create a threat to the sovereignty of developing states has ebbed with the tide of increasing poise within the developing states in running their financial systems. [1394] It would appear that multinational corporations may also have left behind the role of being instruments of the foreign policy of their home states. Sometimes, they have even formed coalitions with developing countries to the disadvantage of their home states.[1395]

[1389] *Ibid.*
[1390] Charles U Ukeje, 'A Farwell to Innocence? African Youth and Violence in the Twenty-first Century' (2012) 6(2) International Journal of Conflict and Violence 338,
[1391] *Ibid.*
[1392] Sornarajah (n 3) 59.
[1393] *Ibid.*
[1394] *Ibid.*
[1395] *Ibid;* The probable instances are coalitions made by oil companies with oil producing states which may be disadvantageous to their home states

However, a number of the larger multinational corporations are capable of carrying out courses of action on foreign soil for their corporate advantage.[1396]

Furthermore, the decline in antagonism towards multinational corporations was advanced by the studies of the United Nations Commission on Transnational Corporations (UNCTC)[1397]. At the same time as sustaining the observation that foreign investment through multinational corporations may perhaps have negative results in specific situations, various studies have shown that, aptly proscribed, multinational corporations could be an engine to stimulate the growth of the developing world.[1398] It can be said without any misgivings that this finding has had consequences in the promotion of a more permissive approach to foreign investment in developing countries and has created the authorised modus operandi which was to come into use to manage foreign investment. It also had an impact on the forms through which developing countries were privileged to receive investments.[1399]

Changes in attitudes have developed over time. The laws that were shaped by the older attitudes have not completely been dismantled by those which are being shaped by the new attitudes.[1400] The studies of the UNCTC on the role of foreign investment have helped developing countries to recognise the useful as well as the damaging effects of multinational activities.[1401] Sornarajah explains:

> *There was clear evidence for the view that foreign "investments made by multinational corporations benefit the local economy through the flow of capital and technology, the generation of new employment and the creation of new opportunities for export income.[1402] For the first time, serious efforts were made to recognise the precise types of activity of multinational corporations which could harm the host economy". This enabled the host countries to take regulatory measures to counter harmful practices. They also resulted in efforts to fashion codes of conduct for*

[1396] *Ibid* 59-60.
[1397] *Ibid;* This body at present is much reduced and now functions within UNCTAD and, in a sign of the times, takes a less forceful position than it had before now.
[1398] *Ibid* 60.
[1399] *Ibid.*
[1400] *Ibid.*
[1401] *Ibid.*
[1402] *Ibid*.

multinational corporations, so generating principles which, though not international law, will have an influence in shaping the course of the development of the law for the future".[1403]

The fundamental issue addressed by the draft codes of conduct was that multinational corporations should avoid certain identifiable conduct which was seen as harmful to the economic development of the poorer states.[1404]

There were practices associated with technology transfer (extensively publicised as one of the benefits brought in by foreign investment) which deprived the host economy of the benefits of the transfer.[1405] Chief amongst these were many limiting clauses introduced into transfer agreements which prevented the transferee from procuring the benefits of the transfer.[1406] They were intended to make the most of the benefit to the transferor, but their indirect effect was to weaken the host economy. Thus, "there were restrictions on the export of the goods manufactured with the technology, grant-back provisions which required that new inventions or adaptations made by the transferee to be given over to the transferor, tie-in clauses which required associated products to be purchased only from the transferor, and similar restrictions controlling the use of technology".[1407]

There is a popular view that, with regards to the allocation of financial benefits, the new financial arrangements will not generate significant shifts. Notwithstanding however, in industries where "bargaining powers continue to shift in favour of the host country, and where host country negotiation skills are sufficiently strong, the changes will be more than political. There will be real changes in who controls the operations and who receives the financial benefits from the projects".[1408] The concept of ownership may have lost some of its significance for managers of companies with experience in arrangements which confer sufficient control over critical decisions and provide attractive financial benefits to the company, with little direct claim to ownership.[1409] On

1403 *Ibid* 60.
1404 *Ibid* 60.
1405 *Ibid* 60-61.
1406 *Ibid* 61.
1407 *Ibid.*
1408 *Ibid.*
1409 *Ibid* 32.

the other hand, the new forms of agreement, while providing a means of sharing symbolic power and economic benefits in ways the traditional concession could not, have not eliminated the complex technical problems relating to the allocation of financial benefits.[1410]

Furthermore, it has been suggested that consecutive financial crises have also hurt the force of the classical view and the impacted on the liberalisation of entry standards to some extent.[1411] Both the Mexican and the Asian financial crises were caused by the sudden withdrawal of foreign investment, particularly portfolio investment.[1412] In the context of these events, there has been some re-examination as to the forms of foreign investment that would be beneficial and those which would not be.

Sornarajah makes reference to studies which show that the technology exported was outdated and dangerous.[1413] Equipment and processes which were antiquated and which, if not long superseded through more advanced knowledge ought to have been, were exported to developing countries who were possibly not sophisticated to recognise what they were receiving. The degree of harm to the environment caused by the export of such technology was identified in these studies, and there have been striking examples of the probable harm to both life and the environment that such outmoded technology could cause.[1414] Such instances show that multinational corporations frequently employ technology which they are not allowed to use in their own states in developing states because it is cheaper to do so and there is no regulation or effective supervision to prevent the use of such harmful technology.[1415]

It would appear that the benefits which multinational corporations bring are also undermined by practices they adopt to protect their commercial interests. By imposing limitations upon the host state as to business practices they are able to espouse on an international scale, they effectively prevent the host state from achieving the maximum

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[1410] *Ibid* 33.
[1411] Sornarajah (n 3) 71.
[1412] *Ibid* 71.
[1413] *Ibid* 72.
[1414] *Ibid.*
[1415] The question has been raised as to whether a home state has responsibility in international law for allowing a multinational corporation to set up in other states with defective technology, the use of which would not have been allowed in the home state. See article by M Sornarajah, 'State Responsibility for Harm Caused by Corporate Nationals Abroad' in C Scott (ed) *Torture As Tort*, (Oxford: Hart 2000) 491.

scope of export potential for the goods manufactured within its territory. The delineation of world markets into sections in which each subsidiary operates may be beneficial to the multinational corporations, but not to the host states, as exports to some areas are effectively barred by this means. Efforts have been made to construct codes on restrictive business practices which have not materialised to any considerable extent, but the efforts themselves also add to the development of international law on foreign investment.[1416] Of topical interest is the movement to include competition as a WTO discipline. Surprisingly, this would appear to be opposed by many developing states, who see in it an attempt to prise open their markets rather than an effort to help them reduce the preventive practices of multinational corporations.[1417]

Foreign investments by multinational corporations can produce good and harm to the economic development, and as such must be carefully regulated. In response, many developing countries, are increasingly enacting regulatory frameworks for such investments by corporations.[1418] For example, "some have legislation designed to ensure that technology transfers are affected without too many restrictions on their use by the transferee".[1419] Globally, this is the basis on which attempts at formulating codes regulating the conduct of multinational corporations are being made. Notably, Sornarajah recognises that "multinational corporations can engineer development if properly harnessed, challenges many propositions relating to international law which have been stated on the basis of the classical theory".[1420]

Sornarajah explains:

> *Unlike the classical theory, which favours, liberalisation and the freedom of movement for multinational corporations on the assumption that this*

[1416] *Ibid* 72.
[1417] *Ibid.*
[1418] In comparison to most developing countries, Australia has taken positive steps to ensure the enactment of proper legislation with regards to the protection of the environment. See Kenneth M Murchison, 'Environmental Law in Australia and the United States: A Comparative Overview' (1995) 22(3) Boston College Environmental Affairs Law Review 503-561. R J Fowler, 'Environmental Law and its Administration in Australia' (1984) 1 Environmental and Planning Law Journal 10; Martin Auster, 'The Harmonisation of Environmental Law: A European-Australian Comparison' (1988) 5 Environmental and Planning Law Journal 276; and Brian J Preston and Charlotte Hanson, 'The Globalisation and Harmonisation of Environmental Law: An Australian Perspective' (2013) 16 Asia Pacific Journal of Environmental Law.
[1419] Ibid 73.
[1420] *Ibid* 73.

> *promotes development, the newer theory requires the recognition of the right of regulation of the foreign investment process by the host state. The classical theory mandated absolute rules of investment protection and their uniform application to all investments. The basis of this position has been shaken by the increasing acceptance of the view that foreign investment should be entitled to protection only on a selective basis. Protection depends on the extent of the benefit it brings the host state and the extent to which it has conducted itself as a good corporate citizen in promoting the economic objectives of the host state.*[1421] *There is a requirement to accept the laws and regulations of the host state which are designed to capture the maximum benefits the foreign investment can bring to the host state's economic development. The quid pro quo for multinational corporations in existing and profiting from operations in the host state is that it should ensure that the laws that seek to link its operations with the economic goals of the state are pursued.*[1422]

The view favoured by some commentators is that a combination of directive and candour is what is seen as popular. The weighty authoritarian regimes which existed in the past have been replaced by regimes based on expediency. The policy of rapid industrialisation desired by developing countries requires capital which only multinational corporations are able to make available. This transformation must be supported by complimentary polices that give due regard to the commercial interests of multinational corporations. For example, the organisation of administrative controls is seen as obligatory to enhance the economic objectives of the state in receiving the foreign investment. The view that all investment has to be cosseted through international minimum standards is no longer a practicable notion, as the practice of states shows that they do not guarantee the idea that all foreign investment is entitled to such a minimum standard.[1423] The superficially imposed minimum standards shield the multinational corporations without the imposition of any analogous duties. That idea has to be abandoned in view of the contending notions that extend protection only to

[1421] It is a settled principle of law that a dishonest investor should not be shielded. This is coming to be stated in the arbitral awards by the host country's law.
[1422] *Ibid* 73 (Emphasis added).
[1423] *Ibid* 74.

multinational corporations which act in accordance with the laws and policies of the host states in which they perform their task. In the alternative, according to Sornarajah, such a minimum standard exists only to the extent that the multinational corporation abides by the regulatory standards directed by the host state. In this sphere it would be impossible for a multinational corporation which causes environmental pollution or does comparable harm in the host state to seek the defence of the minimum standards of treatment in international law, when there is the inevitable attempt by the state to prevent or counter such behaviour.[1424]

Increasingly, international law on environmental protection has yielded greater influence on multinational corporations. This shows that the underlying principle must be formalised in law, in order to compel observation by these corporations. However, there are polarising views on the development of environmental prescriptive measures. This is evidenced by instances where regulatory intervention amounts to an expropriation for which compensation needs to be paid. It is worth emphasising however, that the extent of international law influence on multinationals is difficult to measure, given the fact that cultural, economic and political influences are even more elusive to measure. A more meaningful measurement would be the effect of the multinational company, as opposed to its mere presence which tends to be scrutinised.

Gordon has suggested that the extensive activity of multinational corporations in developing countries has tended to place the blame for nearly all of the negative conditions of the developing countries on the multinational, such as the failure to eliminate poverty, the continued existence of unequal employment opportunities, persistent high levels of unemployment and inflation and an increasingly disproportionate distribution of income as opposed to some movement, however modest, toward a more egalitarian society.[1425] While the multinational enterprises are indeed the cause of many adverse social effects in developed nations, they are not,

[1424] *Ibid* 64.
[1425] Michael W Gordon, 'The Impact of the Multinational Corporation in the Third World', in Kenneth Simmonds (ed) *Legal Problems of Multinational Corporations*, (London: British Institute of International & Comparative Law 1977).

except in rare instances[1426], institutions with wrongful intentions and they are usually quite subject to host nation control.[1427]

Without a doubt, the increasing attempts of developing countries to re-enforce the nation-state concept, have been demonstrated quite clearly in declarations of the United Nations and Developing Countries' organisations. It is hardly surprising that contrasting views are held by the heads of home governments of multinational enterprises; the goal of the multinational enterprise is to provide a return on invested capital, and that of the developing countries to seek a development which will improve the quality of life of its citizens.[1428] What is necessary is to seek structural relationships between multinational enterprises and Developing Countries which are compatible, and which can resolve the real and perceived damaging effects of the multinational enterprise in developing countries.[1429]

In the study's view, the achievement of a balance of interests rests initially in the hands of the developing countries, each of which must develop a framework to regulate the activities of multinational corporations in a manner compatible with the achievement of their desired levels of development. If these nations can formulate such a regulatory framework, an effective framework may require actions in concert through multi-national associations such as geographic and product unions, in order to undermine the efforts of large multinationals to play one nation against another, then perhaps a healthy balance of interests can be arrived at.[1430] The objective must be to identify an international legal framework generally agreed upon by nations as appropriate for the conduct of both multinational enterprises regarding their relationships in developing countries, and, equally important, the obligations of developing countries toward

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[1426] The experience attendant on such corporations as IT&T and United Fruit (now United Brands) presents a distorted view of the aggregate impact of the multinational. See e.g. Subcommittee on Multinational Corporations, Report to the Senate Committee on Foreign Relations on the International Telephone and Telegraph Co. and Chile, 93rd Cong., 1st sess. (comm. print 1973) and Thomas McCann, *An American Company: The Tragedy of United Fruit*. (New York: Crown Publishers 1976).

[1427] The Mexican regulations regarding foreign investment illustrate the form of regulation increasingly being adopted in the developing world. See Michael W Gordon, (1973), 'The Contemporary Mexican Approach to Growth with Foreign Investment: Controlled but Participatory Independence' (1973) 10(1)m *Calif. West L, Rev.* 1.

[1428] Gordon (n 1427) 23.

[1429] *Ibid.*

[1430] Asante (n 4) 358.

multinational enterprises.[1431] With regards to expansion and the like, a government with a system of import controls could have considerable impact on the policy of the multinational company through the administration of import licenses.[1432] Asante rightfully denotes that "gross intervention by governments in these issues could be counterproductive".[1433]

7.7 MULTINATIONALS AND THE OIL COMMUNITIES, THE NIGER DELTA AS A CASE STUDY

The Niger Delta lies in the southernmost part of Nigeria, stretching from the Cameroon boundary in the East to the Ondo–Ogun States boundary in the West. The Niger Delta comprises about 1,600 communities in nine states of the Federal Republic of Nigeria, namely Abia, Akwa Ibom, Bayelsa, Cross River, Delta, Edo, Imo, Ondo and Rivers States with a collective population of more than 20 million people. The strategic location of the area and the actions of its people placed the Niger Delta on a strong path to socio-economic growth rather early on, particularly throughout the period of trans-Saharan trade in Africa.

The Niger Delta is undoubtedly the most exploited, controversial and misunderstood region in sub-Saharan Africa. The plunder of the Niger Delta has turned the quality of life, the status and the well-being of the Niger Delta full circle.[1434] Crude oil has replaced palm oil produce, but the *dramatis personae* are the same – the image of a powerful European multinational company intent on extracting the last life juice out of the richly endowed Niger Delta, and a hapless people struggling valiantly against the juggernaut dates back to the activities of the slave trade, when able-bodied men and women were exported to the New World and Europe to provide the European masters such cheap services as the slaves were intimidated to perform.[1435]

This inhuman trade sucked the people of the Niger Delta into the orbit of international finance capital and, undeniably, laid the starting point for the exploitation of the area's

[1431] *Ibid*.
[1432] *Ibid* 359.
[1433] *Ibid* 359.
[1434] Ike Okonta and Oronto Douglas, *Where Vultures Feast: Shell, Human Rights, and Oil in the Niger Delta*, (New York, Sierra Club Group and Crown Publishers 2001) 2.
[1435] *Ibid.*

resources by outsiders.[1436] For years now, the pattern has remained unchanged and most of these multinationals have added a frighteningly new dimension to this scenario: ecological warfare.[1437] As far back as the colonial times, the region was exploited through the payment of very low price for its agricultural produce, exorbitant prices for its imports and meagre wages to local personnel who served in the civil service and some sectors of the economy.[1438]

The hope of Niger Delta people to change their fate through the practice of federalism throughout the 1960s and 1970s was dashed by the introduction of many negative legislative policies such as the Petroleum Control Decrees of 1967; the Oil in Navigable Waters Act 1968; Mineral Oil (Safety) Regulation Law No 45 of 1968; Oil Terminal Dues of 1969; Petroleum Act of 1968; Land Use Act of 1978, Exclusive Economic Zone Act of 1978, Land Title Vestry Decree of 1993 and the National Inland Waterways Authority Decree of 1977.

Furthermore, oil production in Nigeria has no doubt been "a mixed bag of fortune and misfortune, of blessings and curses dependent largely on who is feeling the pain".[1439] For Nigeria, by and large, it has been a huge blessing in disguise. Apart from its oil revenues, Nigeria's is an almost total agrarian economy and oil revenue thus accounts for about 90% of her foreign exchange earnings and substantially funds her development programmes.[1440]

For the oil communities in Niger Delta, however, oil has been more of a curse than a blessing, particularly those communities where oil exploration and production are carried out onshore. Deforestation, erosion and destroyed farmlands are the main signposts for this supposed gift of nature.[1441] Oil companies' activities in these communities have polluted creeks and destroyed aquatic life.

[1436] *Ibid.*
[1437] *Ibid.*
[1438] *Ibid.*
[1439] Udeme Ekpo, *The Niger Delta and Oil Politics* (Lagos: International Energy Communications Ltd 2004) 40.
[1440] *Ibid.*
[1441] *Ibid* 39.

The balance of power in Nigeria is such that the national interest reigns supreme over local rights.[1442] It has been argued that, in the national arena, an influential individual or dominant group is often able to influence decisions in its favour, creating imbalances, distortions, and inequity. It has also been argued that the Nigerian revenue allocation formula is grossly inadequate since it fails to adequately take into account depreciation and other serious adverse externalities distressing the oil producing areas.[1443]

Nigeria is not alone in this. Even though the exploitation of oil has created some of the largest fortunes and has helped to achieve remarkable economic growth and development, little or no attention has been directed to the impact of this exploitation on the producing areas, particularly in developing countries.[1444]

Another incommodious aspect is that where there are spillages, losses could be unquantifiable.[1445] Even where attempts are made by the companies to pay monetary compensation, such compensation is usually inadequate.[1446] To make matters even worse, "there is also the problem of acid rain, which destroys the houses and environment of people living within the vicinity of oil exploitation and production activities, and which they have to contend with every day of their lives".[1447]

The sizeable oil revenue generated during Nigeria's oil boom, if well managed, offered the potential for improving the lives of the poor through increased investment in health, education, water, roads and other vital necessities.[1448] But if such public funds find their way into governments lacking in transparency and accountability, it is most unlikely that the objective of poverty reduction will be achieved. To nobody's surprise, matters for the communities and the poor at large are likely to worsen.[1449]

1442 *Ibid.*
1443 *Ibid.*
1444 S Roberto, 'The impact of oil operations on the producing regions of Southern Mexico' (1983) 5(1) *Third World Planning Review* 40.
1445 Ekpo (n 1439) 39.
1446 *Ibid* 40.
1447 *Ibid* 40.
1448 *Ibid* 56.
1449 *Ibid.*

Furthermore, it is a popular view amongst economic and political theorists that oil in the Niger Delta has been a curse on the nation.[1450] This so-called resource curse theory explains the restiveness of the Niger Delta communities, which has transformed the communities into a breeding ground of vandalism of oil installations, kidnappings of foreign workers, just to mention a few. A formerly peaceful and stable region, the Niger Delta has given way to violence and crisis, due to community disapproval of these activities.[1451]

At this juncture, it is worth highlighting that whilst the black letter law enshrines oil resources ownership and control in the Nigerian government, the reality is that the government itself continuously struggle to assert these rights against the multinational companies. The global oil industry for example, is dominated by a few major super-companies such as ExxonMobil, Royal Dutch Shell and BP; all of which have a heavy presence in the Niger Delta. These companies have superior access to capital and technology in an industry extremely dependent on both. The fact remains that these companies most often stunt the growth of other sectors. Take Nigeria for example, that was an agricultural based economy, before the discovery and development of oil. Moreover, the disproportion of wealth, power and knowledge between international oil companies and host government means that oil companies can drive hard bargains over the percentage of oil profits accruing to them.

Africans, desperate to change the unchanging nature of colonialism in their territories, allege that the formation and execution of foreign policy, especially in oil-producing nations, has been deliberately tied to foreign oppression, exploitation and the trappings of imperial ambition by multinational corporations which are nurtured and supported by

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[1450] Many theorists often consider Nigeria as the poster child of the resource curse. The resource curse was a term developed by economic theorists to describe the adverse impact on economic growth by natural resource abundance. For further commentaries, see Andrew Williams, 'Shining a Light on the Resource Curse: An Empirical Analysis of the Relationship between Natural Resources, Transparency, and Economic Growth' (2011) 39(4) World Development 490-505; W Max Corden and J Peter Neary, 'Booming Sector and De-industrialisation in a Small Open Economy' (1982) 92 Economic Journal 825-848 and W Max Corden 'Booming Sector and Dutch Disease Economics: Survey and Consolidation' (1984) 36(3) Oxford Economic Papers 359; Jeffrey D Sachs and Andrew M Warner 'Natural Resource abundance and Economic Growth' (1995) 5398 NBER Working Paper 1-50 and Jeffrey D Sachs and Andrew M Warner, 'Natural Resource and economic development: the curse of natural resources' (2001) 46 European Economic Review 827-838; Larry Diamond and Jack Mosbacher, 'Petroleum to the People: Africa's Coming Resource Curse – and how to Avoid It' (2013) Foreign Affairs.

[1451] V Ojakorotu, 'Anatomy of the Niger Delta crisis: causes, consequences and opportunities for peace (2010) 3 LIT Verlag Munster.

their respective imperial centres.[1452] The reaction to the experience in Africa is such that multinational corporations are regarded as being neo-colonialist.[1453] According to Nkrumah, the past president of Ghana observed:

> *"Africa is a paradox, which illustrates and highlights neo-colonialism. Her earth is rich, yet the products that come from above and below her soil continue to enrich not Africans predominantly, but groups and individuals who operate to Africa impoverishment… If Africa's multiple resources were use din her own development they could place her amongst the modernised continents of the world but her resource have been and still are being used for the greater development of oversees interest"*[1454]

It is not out of place to say that such conflict amongst the oil producing communities of the Niger Delta reflects the widespread collapse of public order in the country. These inordinate conflicts derive from the depth of social frustration and anger harboured by the oil communities. These grievances, however, are directed first against elements they consider having sold out their communal heritage; secondly, against the oil companies, whose years of exploration and production have so far yielded little positive development; and thirdly, against the 'distant' Nigerian state, more concerned over what it accumulates than caring about the proverbial goose that lays the golden egg[1455].

The truth is that, most of the violent conflicts in contemporary Nigeria, especially those in the oil-rich area of the Delta State, reveal, in unequivocal terms, the inherent weakness of the state institutions.[1456] The state, in order to resolve these anomalies, has resorted to a strong preference for military coercion to suppress such incessant militant groups, whose activities destroy the production of oil in these communities.[1457] The oil-rich communities are now "on the boil, and they have struck out for self-determination, insisting on a new Nigeria informed by true federalism, equity, justice

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[1452] Bingu W T Mulharika discussed in Isaac Igweonwu, 'A Theoretical Perspective on Negotiations with Reference to the International Oil Industry' (1988) 11(2) OPEC 181.
[1453] Kwame Nkrumah, *Neo-Colonialism, the Last Stage of Imperialism* (Thomas Nelson & Sons Ltd, 1st edition 1965) 1-2.
[1454] *Ibid.*
[1455] Charles Ukeje, 'Youth, Violence and the collapse of Public Order in the Niger Delta' (2001) XXVI (1 and 2) 337, 338. See also Okonta and Douglas (n 1381) 19.
[1456] *Ibid* 338.
[1457] *Ibid* 338.

and negotiated co-operation".[1458] They are agitating that multinational companies should be held accountable and compelled to pay reparations for the devastation caused to their environment and lives.

Another notable factor is the emergence of a new generation of well-educated youth, aware of the disparity between urban and rural centres and believing that the multinational oil companies have the wherewithal to redress the forever-growing social gap. It is a known fact that Nigerian economy runs on oil extracted from the Niger Delta region of the country[1459].

Oil is the mainstay of Nigeria's economy and the interest and stakes of key players, especially the state and international oil companies, in the oil economy are reasonably high. To a great extent, and for understandable reasons, "the majority of the oil-bearing communities and the people of Niger Delta region adopt a counter-hegemonic and anti-oil stakeholders' discourse and orientation".[1460]

Several scholars[1461] cite the fact that statistics from the Central Bank of Nigeria clearly support the various research findings. On record is a recent Central Bank of Nigeria report finding that Nigeria earned about $2.9 billion from oil during the month of January 2006 alone.[1462] This underscores the importance of oil to the Nigerian economy. On the international scene, Nigerian oil is of great importance, it being the eighth largest producer of oil in the world, and therefore any form of disruption to the oil supply from Nigeria would have serious consequences to the global oil supply and no doubt result in an escalation of world oil prices when one compares it to the widespread

[1458] Okonta and Douglas (n 1434) 19.
[1459] Before the discovery of oil in 1956 at Oilober, the Nigerian economy was agro based. They key agricultural products were cocoa, groundnut and palm oil. See W Graf, *The Nigerian State: Political Economy, State Class and Political System in the Post-Colonial Era* (London: James Curry 1988) 9; D Robinson, *Ogoni: The Struggle Continues* (Geneva: World Council of Churches 1996) 9. The rise of oil revenue led to the affliction of the Dutch Disease see T L Karl, *The Paradox of Plenty: Oil Boom and Petro-States* (Berkeley: University of California Press 1997).
[1460] Kenneth C Omeje, *High Stakes and Stakeholders: Oil Conflict and Security in Nigeria* (Aldershot, Hampshire & Burlington, Vermont: Ashgate 2006) 1.
[1461] A A Ikein, *The Impact of Oil on a Developing Country: The Case of Nigeria* (New York: Praeger 1990) 28; S A Khan, *Nigeria: The Political Economy of Oil* (Oxford: Oxford University Press 1994).
[1462] *Ibid.*

conflict in the middle East which already accounts for an enormous supply of oil for the world oil reserves.[1463]

There is no doubt that despite the fact it contributes to the Nigerian and global economy, Nigerian oil has been a source of huge profit for multinational oil companies. It can be argued that, "like most oil and gas export dependent states of the Middle East and North Africa, Nigeria has the constitutional framework of a rentier state. But unlike the typical rentier state of the Arabian Gulf and Maghreb region, the Nigerian state lacks a coalescence of political structures in which the national identity and hegemonic elite interests are both preceded by and predicated on the invocation of a common supranational idiom of cultural heritage such as pan-Islamism, sovereign or constitutional manacling and pan-Arabism".[1464]

Simply stated, a rentier state is a state reliant not on the surplus production of the domestic population or economy but on externally generated revenues or rents, usually derived from an extractive industry such as oil,[1465] It lacks a productive outlook in the sense that revenues from natural resources really contribute a significant proportion of the gross domestic product and dominate national income distribution, in most cases at the expense of the real production sectors of the economy.[1466] In most rentier states, such as those in Africa and the Middle East, considerable political influence is wielded by the rentier elites. For instance, Nigeria is a colonial creation controlled by a coterie of men who are endemically individualistic with a tenuous productive base but lavishly ostentatious.[1467] In a rentier state, the distribution of revenue, in the absence of stable and well-developed legal, political and bureaucratic institutions, tends to encourage corruption. The tendency towards corruption is also compounded by the pervasiveness of a patrimonial political culture.[1468]

[1463] *Ibid.*
[1464] P M Lewis, 'The Dysfunctional State of Nigeria' in Nancy Birdshall, Milan Vaishnav and Robert L Ayres (eds) *Short of the Goal: U.S. Policy and. Poorly Performing States* (Washington DC: Center for Global Development 1998) 83-116. (Emphasis added)
[1465] Ahmet Kuru, 'The Rentier State Model and Central Asian Studies: The Turkmen Case' (2002) 1 Turkish Journal of International Relations 52.
[1466] *Ibid* 53-55.
[1467] *Ibid* 56.
[1468] *Ibid* 57.

A 2006 United Nations Development Programme (UNDP) report also concludes that "the Niger Delta is a region suffering from administrative neglect, crumbling social infrastructure and services, high unemployment, social deprivation, abject poverty, filth and squalor"[1469] What's more, the account affirms that "the prevailing state of affairs not only elucidates the escalating waves of restlessness in the region, it also signifies a bleak future for the area and the country" and that "if unaddressed, these do not augur well for the future of Nigeria or an oil hungry world."[1470]

Significantly, the foregoing is in unwavering agreement with earlier findings of several commentators and they favour the view that the quandary is both consistent and long-lasting.[1471] In an investigation carried out in the mid-1990s the World Council of Churches (WCC), Geneva, pointedly put forward its conclusion as follows:

> *It is clear that the oil boom resulted in numerous financially capital-intensive projects, including the expansion of the network of roads, and of course the development of the new capital city Abuja. Most of this development took place in the non-oil-producing areas. The oil-producing areas were, and still are, some of the least developed in the country. There is no electricity, running (potable) water, no telephones, no good roads, poor health care facilities, etc. People in Ogoni land, and other minority groups in the Niger Delta live in similar or even worse conditions. The revenues from oil have bought incredible modernisation and development to some regions of Nigeria but have had little positive impact on the oil-producing areas.*[1472]

[1469] UNDP, *Niger Delta Human Development Report* (2006) <http://hdr.undp.org/doc/report/national/NIR> accessed 20 January 2018.

[1470] The report rightly captured the mood in the region when it found that for most people of the Delta, progress and hope remain out of reach. See Kaniye S A Ebeku, 'Oil, Niger Delta and the New Development Initiative: Some Reflections from Socio-Legal Perspective' (2006) 3 OGEL 4.

[1471] In the meeting held on the 5th of April 2006, it was reiterated by stakeholders in that meeting that underdevelopment is a long-standing problem of the Niger Delta community. See 'Government Raises Fresh Panel on Niger Delta' (2006) <http/odili.net/news/sources/2006/apr/6/32.32.html,30/07/06> accessed 20 January 2018.

[1472] D Robinson, *Ogoni the Struggle Continues* (Geneva: World Council of Churches 1996); B Naanen,'Oil Producing Minorities and the Restructuring of Nigerian Federalism. The Case of the Ogoni People' (1995) 33 Journal of Commonwealth and Comparative Politics 46, 65.

Furthermore, the state of underdevelopment of the Niger Delta region is a well-known fact all over the world, thanks to the higher profile given to the matter in recent times by the recurrent actions of militant youths in the region. For example, the kidnapping of foreign oil workers which causes the world oil prices to rise has attracted the attention of national and international news media which have focused on the developmental despair of the Niger Delta region of Nigeria. Significantly, neither the federal government of Nigeria nor the multinational oil companies operating in the Niger Delta deny that the Niger Delta region is underdeveloped and neglected, and its indigenous inhabitants are poor.[1473] Without a doubt, the oil companies exert a lot of influence but allegedly they do not employ their position to bring about development in the area they work in[1474].

Firstly, most of the multinational oil companies, given their long history of exploiting resources in the Niger Delta, such as Shell, are well aware that the region is devastated and neglected by the federal government and consider reinvesting some of its oil revenues for the development of the region.[1475] They argue that their operations are guided by specific contractual terms with which they have complied. They also distinguish their role, being a private enterprise, from that of the government as provider of social services to its population.[1476] This argument, however, does not hold water since corporate constructive social engagement is not statutory but in fact an obligatory ingredient of stakeholder management. Corporate practice has shown that effective management of stakeholders' relations can be a prerequisite for the win-win outcome for a firm and its stakeholders in the form of increased revenue stock value and profit for the firm.[1477]

[1473] See Human Rights Watch, The Price of Oil: corporate responsibility and human rights violations in Nigeria's oil producing communities (New York: Human Rights Watch 1999) 159; E Hutchful, 'Oil Companies and Environmental Pollution in Nigeria' in Claude Ake (ed) *Political Economy of Nigeria* (London: Longman 1985).

[1474] M Ibeleme, 'Nigeria: the politics of Marginalization' (2000) Current History: A Journal of Contemporary World Affairs 211-214.

[1475] *Ibid.*

[1476] *Ibid.*

[1477] R Boele, H Fabig and D Wheeler, 'Shell, Nigeria and Ogoni: A Study in Sustainable Development' (2001) 11 Corporate Social Responsibility and Stake Management 121, 125.

Secondly, on behalf of the Nigerian State, the past and present Presidents[1478] of Nigeria have severally reiterated that 'it is unfair for south-south [Niger Delta] state, the producers of the nation's wealth, to mope in penury whilst the resources from their areas are used to develop other parts of the country'. It is also worth mentioning that the Nigerian State recognises in a *note verbale*[1479] sent to the African Commission on Human and Peoples' Rights the 'gravamen' of allegations of environmental degradation, neglect of the Niger Delta, and violations of human rights in the pursuit of 'protection' of oil installations.[1480]

The Niger Delta people regard as unjust and inequitable the pervasive poverty amongst them and the underdevelopment of their region and perceive this as an even keener insult precisely because of the mammoth revenues which oil operations in their region have yielded and continue to yield to the Nigerian State.[1481] The people of the area have continued to agitate vociferously about extreme poverty, hunger and disease, environmental degradation and loss of their traditional means of livelihood.[1482]

7.8 RESOURCE CONTROL

The supremacy of control resources bestowed by the 1999 constitution on the government of the federation is absolute.[1483] For that reason, the said government is permitted to exercise such power in accordance with its own judgment and or as may be approved by the legislative authority of the federation, namely the National Assembly.[1484]

Over the years, several local pressure groups and organisations have made demands of the Federal Government of Nigeria and also of multinationals for attenuation of the

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[1478] General Abubaker, as Head of State, has, in the 1999 budget, described the situation of pervasive poverty and underdevelopment in the Niger Delta as 'a sad story'. President Olusegun Obasanjo expressed similar sentiment.

[1479] In a Note verbal was dated 16th February 2000 and referred 127/2000.

[1480] Communication 155/96 of The Social and Economic Rights Actions Centre and the Centre for Economic and Social Rights/Nigeria (decided at the 30th Ordinary Section or the African Commission on Human and Peoples' Rights held in Banjul, in the Gambia from 13th to 27th the October 2001) paras 30 and 42.

[1481] Ebeku (n 1470) 12.

[1482] Diepreye Alamieyesiegha, 'Nigeria: The Way Forward' < https://allafrica.com/stories/200410181341.html> accessed 10 July 2018.

[1483] See section 44(3) of the 1999 Constitution Laws of the Federation. See also section 1(1) of the Petroleum Act 1969.

[1484] *Ibid.*

poverty of the peoples of the Niger Delta and the development of the region. Following on from the initiation of the quest for resource control which was advocated by the regional governments, there arose agitation for local ownership of the land and petroleum occurring thereon. This demand had the support and advocacy of the communities but not the governments.[1485] The most important part of their demands has been captured in two important documents or declarations of rights, specifically: the Ogoni Bill of Rights (1990, with a 1991 appendix) and the Kaiama Declaration (1998)[1486]. The people are demanding what they call 'resources control'. The subject of resource control is a catch-phrase for the demand for ownership and control of natural resources to be vested completely, or at least to a certain extent, in the constituent states of the Nigerian Federation or communities where they are naturally located and not, as at the moment, solely in the Federal Government.[1487]

The agitation for resource control is naturally tied to the demand for the control of land. The people of the area point to other parts of the country, for example the north, where traditional rulers hold land in trust for the people. They avow that this was the practice in the Niger Delta as well, right from the earliest times until oil was discovered in the area.[1488] The demand for resource control has not been limited to the Niger Delta, where the major resources are oil and gas, but runs through the entire south where the call has been loudest for the practice of federalism. Further, the people are demanding the right to political and economic self-determination within the Nigerian State.[1489]

It is significant to underscore the benevolence in the meaning of 'resources control' in the various declarations of rights of the people; 'resources control' means much more than just a fair share of oil and gas revenue. It is noteworthy that documents such as

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[1485] Patrick Ndubisi Oche, *Petroleum Law in Nigeria: Arrangements for Upstream Operations*, (Published in Jos, Nigeria, January 2004 by Heirs Great Commission 2004) 35.
[1486] Declared by Ijaw (Niger State) Youths in December 1998. The full text is online at <http://www.ijawland.com/kaiama_declaration.html> accessed 20 January 2018
[1487] Victor Attah, 'Understanding Resources Control'(1998) <http:www.dawodu.com/attah l.htm,22/7/06> accessed 20 January 2018. The exclusive rights to the ownership of oil is vested in the Federal Government of Nigeria by Section 1 of the Petroleum Act 1969 and section 43 (3) of the Constitution of the Federal Republic of Nigeria 1999.
[1488] Ekpo (n 1439) 135.
[1489] *Ibid.*

the Ogoni Bill of Rights and the Kaima Declaration are not in any way at all secessionist in character but are simply calls for justice and development by deprived people.[1490]

Also, a cautious look at the specifics of the demands of the people of the Niger Delta as contained in their various declarations of rights suggests that 'resources control' includes rights to be involved in the exploitation of oil resources and the management of the environment: (with the related rights, *inter alia*, to obtain some royalties). Furthermore, it includes customary rights to ownership and control of land, forests and water which the Nigerian States has allegedly expropriated by various statutes, including the Petroleum Act 1969 and the Land Use Act 1978.[1491]

What is more, in Nigerian history, no matter has been as contentious and controversial as resource control. People in the south view it as the only answer to the fundamental question of how to guarantee justice and fair play in the handling of resources of nature particularly when the exploration of such resources carries with it negative consequences for the environment. Many from the north regard such agitation as an invitation to anarchy and express a preference for a stronger Federal Government that would be more responsible for all the other parts of the country.[1492] Behind these preferences for a stronger government at the centre is a sense of suspicion and misgiving that, given control of their resources, there could be a grand design by states with colossal wealth to seek independence from Nigeria.[1493]

One of the problems with state control of petroleum is the apparent complexity of being able to guarantee transparency of successive leadership in the State over the issue. Another quandary is that inter-state wrangling is likely to become the order of the day, and yet a further likely scenario is that the success of the Niger Delta States in wresting control of petroleum from the Government of the Federation is that it could lead to

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[1490] *Ibid;* These documents are available on line at http//www.nigerianscholar.africangueen.com.the Ogoni Bill of Rights is by the Ogoni people while the Kaiama Declaration was prepared by the Ijaws. Both are Niger Delta ethnic groups.

[1491] Cap 202, LFN 1990.

[1492] Oche (n 1485).

[1493] *Ibid.*

analogous agitation by individuals, families and/or communities in petroleum-bearing localities.[1494] Thus, agitation from Local Government Areas cannot be ruled out.[1495]

7.9 OWNERSHIP OF MINERAL RESOURCES

As with ownership of land, ownership of mineral resources (including oil) varies from one jurisdiction to the other. For example, oil resources could be owned entirely by the state or in some cases by individuals or private enterprise. It could also be owned together, in some form of joint ownership by the state and the private sector. It is important to note also that despite the fact that land in the strict sense is not subject to absolute ownership because it cannot be destroyed, mineral oil, on the other hand, is a consumable asset and is subject to absolute ownership in the legal sense, in that right in respect of it may consist of right of free as well as exclusive enjoyment, including the right of using altering, disposing of or destroying it.

Where mineral resources are owned by the State, development operations are then subject to the acquisition of rights from the Government authorities, generally in the form of concessions or leases, preceded in some cases by licenses or permits.[1496] In such a situation Governmental grants of permits, licenses, leases and concessions are an important means of controlling the acquisition and the extent of rights of foreigners in a country's mineral resources.

With regards to petroleum exploitation, it is useful to pause to example some case law on the comparison with permeable water resorted to in the English case of Denton v. Blundell.[1497] This comparison was satisfactorily demonstrated in the American case of Banord v Bouongahela Natural Gas Co. Ltd.[1498] The issue that was pleaded in this case was whether an injunction to prohibit drilling by a land owner on adjacent land could be issued on grounds of damage to the plaintiff's land by permeation. The Court, however, denied the remedy on the grounds that the Court was incapable of determining the extent or nature of damage to the plaintiff's land, and the idea that mineral oil is not

[1494] *Ibid.*
[1495] *Ibid.*
[1496] In the context of Nigeria's oil industry, there are only three types of concessions, namely, exploration, prospecting and mining – Schedule 2, para. 1, of the Petroleum Profit Tax Act, 1959.
[1497] *Denton v Blundell* [1843] 12 M.&W. 324.
[1498] *Banord v Bouongahela Natural Gas Co Ltd* [1807] 216 Pa 362.65 Atl. 801.

capable of being easily owned in situ because of its migratory nature was recognised. There is a whole range of decided cases which have since established the theory in the American Law of Property.[1499]

Wherever private ownership is in fashion, it is customary for the owner to either grant the mineral rights outright, or by an agreement of lease or otherwise contract out to a company or some similar entity, the right to remove the mineral for an agreed financial consideration. There may also be a mixed bag of private and State ownership or the State may reserve its right to specific minerals, such as uranium while leaving the residuary minerals to private ownership, such as in Austria. As has been observed in this study, where mineral resources are owned by the State, exploitation may be undertaken by private enterprise, foreign or indigenous in accordance with the mining legislation of the State or by some other special arrangement e.g. as in Britain. For many decades, Nigeria was a protégé of Britain, belonging to the same common law jurisdiction and having most of our laws in important areas such as land, companies, natural resources etc. fashioned after those of Britain.[1500]

In developing countries, there is a general unwillingness to put mineral oil resources at the disposal of individuals. This is logical. To do so, it is assumed, would breed a class of wealthy tycoons in countries where, because of the poverty which permeates society, government programmes should aspire to an even development and improved standard of living for all. However, the capital and technical know-how for the exploitation of minerals is lacking in developing countries. As a result, legislation is therefore geared towards investing ownership in the State which, as owner, may then contract out mineral resources exploitation to foreign enterprises for a fixed term and under specific conditions which are typically concluded under concession agreements. The Venezuelan Mining Law of 29 December 1944, as amended, declares all mines, seams, beds or mineral deposits to be public utilities and under that country's constitution they are only to be exploited under a concession granted by a National Executive Power.

[1499] *Brown v Humble Oil Refining Company Limited* [1935] 126 Tex.296, 101ALR 1393.
[1500] Ajomo (n 416) 332.

Also, the Libyan Petroleum Law is even more categorical.[1501] It affirms that all petroleum in its natural state in strata is the property of the State and no person may explore, mine or produce petroleum without a permit or concession. The Zambian Mines and Minerals Act no. 32 of 1976 and the Mines and Minerals Act of Botswana[1502] vests the property in all minerals in the State for the common benefit of the people in spite of any right of ownership which any person may possess in and to the soil on or under which minerals are found or situated. Furthermore, the ownership of natural resources and the ownership of land in Nigeria are debatably based on the 'Regalian Doctrine' and the power of 'Eminent Domain' in that order. The 'Regalian Doctrine' or *jura regalia* 'refers to royal rights, or those rights which the King (State) has by virtue of his (its) prerogatives'. On the other hand, the power of 'Eminent Domain' is the power of the State to expropriate suitable private property for its own exploitation without the owner's consent. The legal rewards enjoyed by oil companies in the framework of this controversial act in fact distance oil communities from their traditional and cultural resources. This is the background against which land has become the most debatable resource in the Niger Delta and the frequent cause of intra-community and inter-community disputes on one hand and most of those between oil communities and the Multinational Oil Companies on the other.

Lesser incidents are usual. In addition to the pollution and hazards associated with spills, oil production in the Delta has extremely negative environmental impacts due to the prevalent practice of gas flaring. The natural gas produced as a derivative of oil production is burned, creating incessant, high-intensity flames. While associated natural gas is commonly captured and sold or used as a local energy source, in Nigeria the lack of delivery and utilisation infrastructures for natural gas render it a by-product which cannot be exploited. It is by and large The above is a partial outline of the reasons why the tensions and conflicts over land have become a frequent and major bone of contention between oil companies and their hosts. Apparently, once oil is discovered, the area on and under which the discovery has been made automatically becomes contested amongst previously peaceful neighbours, owing to the privileges and perks

[1501] *Ibid* 333.
[1502] *Laws of Botswana* cap 6601 sec.2.

that come out of it. The unfavourable impact of oil operations must therefore be appreciated, mostly with reference to land.

Although some conflicts over land in the region have antecedents that preceded the discovery of oil, ignorance of (and disdain for) customary land rights and local customs on the part of multinational oil companies worsen existing disputes and produce new ones.

In the framework of the controversial legislation hitherto in force, the benefits which oil companies enjoy by effectively not being required to prevent pollution in the first place or to make any meaningful legal recompense which is more than derisory for the harm sustained by the oil communities, effectively deprive oil communities from their traditional and cultural resources. This is the background against which land has become the most controversial resource in the Niger Delta, and the unrelenting factor destroying intra-community and inter-community harmony on the one hand and fuelling conflict between the oil communities and Multinational Oil Companies, on the other.

7.10 THE QUESTION OF RESPONSIBILITY FOR SECURITY

As a final point, security has turned out to be one of the foremost concerns in the Niger Delta with the substantial attendance of state security and the explosive burgeoning of unofficial security networks and hardnosed criminal gangsters who flourish on political support, illicit oil bunkering and gun-running. Within such an unhinged atmosphere marked by barefaced human rights abuses and state repression, violence overwhelmingly offers a self-fulfilling example that is inimical to peace, stability and national development. Activities by belligerent groups ranging from the Egbesu fraternities, the Bakassi Movement for Self-determination, to the Niger-Delta Avengers are well documented.[1503]

However, it is important to note that when the objective situation of a group or community is repressed through violence, social values also become militarised. Since the commencement of the 1990s, when aggressive conflicts began to assume an

[1503] John Boye Ejobowah, 'Who Owns the Oil? The Politics of Ethnicity in the Niger Delta of Nigeria' (2000) 47(1) Indiana University Press 29; A Ajayi, 'Niger Delta and Resource Control' (2005) Lagos: Bangee Ventures Limited.

unparalleled scale that has threatened domestic stability in the oil region and throughout the country, social ferocity has attained a frightening level with the explosion of militant youth groups whose activities confront and weaken traditional social order in various parts of the oil area. These community iconoclasts who always tend to thrive in disturbed situations, seem to spare no efforts in organising pipeline ruptures, thefts and other forms of sabotage. They can be quite sophisticated in their methods and so elicit the sympathies of the uninformed. Thus, as already stated, examples include the 'Egbesu boys' and a host of other criminal gangs.

7.11 HISTORICAL DIVIDE AND RULE TACTICS

Historically, multinational oil companies gained influence and control of the areas they now exploit through spending a great deal of time, effort and money on a network of local patrons.[1504] Oil companies set up a self-serving divide-and-rule arrangement which regularly played neighbouring communities (or groups within each community) against each other and it is reasonable to suggest that this approach may have become rather ingrained.

Following on from this, it can be seen that in response to the civil unrest now being encountered, oil companies from time to time call upon and exploit their historical direct and unhindered admittance to the instrumentality of official intimidation to beef up their protection and power in their areas of operation.[1505] This lack of ethical standards in their approach to the real social problems throughout the Delta region goes a long way towards revealing a callous mindset surrounding the actions of multinationals in the resource-endowed but impecunious Niger Delta and the Nigerian State.[1506]

7.12 THE WAY FORWARD

It is apparent that grassroots mobilisation and violent behaviour are unlikely to end for a long time, bearing in mind how the social values amongst the oil communities have become disrupted and perverted beyond recognition. There are no hard and fast rules

[1504] Okonta and Douglas (n 1434) 200.
[1505] *Ibid.*
[1506] *Ibid* 200-201.

about the best way to restore the long list of developmental tragedies facing the oil communities.

It is fair to assert that what must be recognised at some point is that the current situation is unsustainable. For the long-term health of the area and of the interests in exploiting its resources, it is clear that, sooner rather than later, a turn-around in approach will be required, with a realisation that the true patrons whose support needs to be solicited for the future are the communities themselves, and not the old-fashioned corrupt ruling class of officialdom. A serious and genuine commitment to expand and deepen democratic participation by government and the people would definitely set a good tone accompanied by a serious investment in improving their material well-being.

From the foregoing, there is no denying the fact that some ground has already been covered in the past few years since the commencement of democratic rule. However, the oil communities are concerned that the much-vaunted dividend of democracy is still an object of distant and wistful thinking. Arguably, real democracy could bring about positive transformations to the present bellicose approach to law and order in the Niger Delta and the nation at large.

To sum up, this brings the study to the last chapter, the protection of communities should be in the form of enacting municipal laws and regulations which take into account their particular status and not through claims of local ownership. The movement promoting community ownership of natural resources of some sort is designed at tackling this current inequality. It must be emphasised that no matter how bleak the prospects for peace and security may seem to be in the Niger Delta, a legitimately staunch civilian government which acts with sufficient determination to achieve necessary reform stands a far better chance than the military to beneficially reorganise past and present policy failures and to face the various challenges the future holds.

CHAPTER EIGHT

CONCLUSION AND RECOMMENDATIONS

This chapter presents the conclusion through comparing the actual research outcome with the objective and the research questions set at the beginning of the research. The conclusion will aim to recapitulate some of the main themes which have been extensively discussed in this study, draw some conclusions and make some recommendations. More specifically answers were sought to the following:

Research question: whether the joint venture and production sharing contracts are mutually beneficial to the parties involved (the foreign oil company and the host country). The specific question raised here is how petroleum arrangements can be improved for the benefit of all parties, including the interests of the world community at large and those of future generations. Further, whether the existing regime requires change or improvements, whether and how the management of production sharing contracts and joint venture agreements could be improved or complemented using some contractual devices such as stabilisation clauses in negotiations and enshrining in all these agreements, the proper law in case there is a dispute in such arrangements. The research has addressed the following key issues:

(1) What is the current legal framework for production sharing agreements and joint venture agreements in the petroleum sector?

(2) What are the differences between a production sharing contract and a joint venture?

(3) How did they originate and what has been their subsequent development?

(4) What are the desirable improvements to these contracts and how can these be implemented?

(5) How different clauses like renegotiation clauses, stabilization clauses and choice of law are imperative in such contracts to make them more equitable.

(6) How the bargaining positions of the developing countries and the multinational have changed over time.

(7) How agreements can be geared to protect the needs for sustainable development and protection of the environment.

8.1 AGREEMENTS CHANGED ALONGSIDE LEGAL, POLITICAL, AND LEGISLATIVE DEVELOPMENTS

The legal categorisation of the agreements has changed from concessions to other forms, such as, Joint Ventures, Production Sharing Contacts, Work Contracts, and so forth.[1507] Some writers have expressed the view that this change is not as important as it may look, and that as regards to substantive rights and obligations, the new kinds of agreements do not differ very much from concessions.[1508] More or less all the developing countries have established certain legal and political changes within their national law by means of wide-ranging or special legislation pertaining to their natural resources, or by constitutional provisions which provide for state or public ownership of natural resources.[1509]

Still, in respect of pre-existing concessionary rights, multinationals have come to accept the retroactive effect of such legislation or constitutional provisions. The legal institutions so laboriously established to protect foreign commerce in the past have not been adequate to meet the nationalist demands of newly powerful countries. At best, international law is not self-executing, but rather depends on the consensus of nations with respect to political and moral precepts. The accession of great numbers of newly independent countries to the community of nations, many with ancient cultures or new economic regimes far different from those dominating the international community in the past, are bound to put unprecedented strains on this consensus.[1510]

Concessions which grant ownership rights to the multinationals are now inconsistent with the rights of permanent sovereignty of the state. Even if the economic benefits to the parties are the same in both concessions and other forms of agreements, the political value of the change to the states is important and substantial.[1511]

1507 David N Smith and Louis T Wells Jr, 'Mineral Agreements in Developing Countries: Structures and Substance' (1975) 69 AJIL 3 560-590.
1508 *Ibid*.
1509 Cattan (n 639) 84- 85.
1510 Muir J Dapray, Partner, Berliner, Maloney, Gimer & Muir, Washington, D.C. Vice Chairman, Committee on International Economic Organisations, American Bar Association, International Law Section. Formerly Assistant Legal Adviser for Economic & Business Affairs, U.S Department of State from 1971-73: 'The Changing International Framework of International Energy Management' (1975) 9 Int'l L. 605. Based on remarks to the World Energy Conference Legal Seminars, September 25, 1974, at Detroit, Michigan.
1511 The political survival of the governments in many developing countries may depend on how well they are deemed to manage the national patrimony. Calling an agreement, a 'concession' rather than

The old form of concessions, which granted extensive and absolute ownership rights as well as extensive control over a large territory of the granting state, was no longer politically or economically acceptable to the developing countries. Smith and Wells discuss that traditional concession agreements endured as the elusive institutional framework defining the commercial and legal relationship between energy-producing countries and international oil companies.[1512] The concession agreements reflect a passive role for the host state, which was confined to receiving royalties for the oil that was exported. The concession agreement is no longer used, as the oil-producing countries have sought greater control over the industry.[1513] The new agreements, which replaced the concession agreements, reflect in every way the fact that there has been a shift of power away from the oil companies to the oil-producing states.[1514]

The early concession regime was based on power politics and a 'big oil' strategy rather than partnership and cooperation.[1515] As a result, the concession regime bestowed on the major oil companies nearly complete freedom to conduct petroleum operations in the home states.[1516] Governments had little control over either their resources or the companies operating within their territories. The notion of mutuality of interest was not even seriously entertained under the concession regime.[1517] As such, the concession system came under increasing pressure by the host-country governments for a more equitable sharing of the gains and ultimately went through various stages of renegotiating, revision, nationalisation, and eventful termination.[1518]

8.2 BALANCE, STABILITY AND MUTUAL BENEFIT AS OBJECTIVES FOR AGREEMENTS

The study has demonstrated that traditional concession agreements largely fail to develop a balanced, indefatigable, unchanging and mutually beneficial relationship between the contracting parties.

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giving it a label indicating state ownership, especially when the laws of the State require such a label would spell the doom of the Government.

1512 Smith and Wells (n 1507) 561.

1513 Gao (n 83) 20.

1514 *Ibid.*

1515 *Ibid.*

1516 *Ibid.*

1517 *Ibid.*

1518 *Ibid.*

Concerns for natural resource preservation and sustainable development were not articulated at all during this period. The last quarter of the twentieth century not only observed the waning of the old concession system but saw stable development of new contractual arrangements.

This progression from traditional concession agreements to modern petroleum contracts has been viewed by some developing countries as a 'revolutionary process' which would wholly restructure the legal relationships between governments and companies in the years to come.[1519] As a result, agreements such as those considered by Lord McNair are rare today. They have been either renegotiated or the lands to which they related have been expropriated by developing countries in the exercise of their permanent sovereignty over their natural resources.[1520]

8.3 THE THRUST FOR REAL PARTICIPATION

The study is of the view that the sharing of financial benefits in natural resource development agreements has changed. With respect to petroleum and other important natural resources development agreements, the producing countries are no longer interested merely in collecting taxes and royalties; they now seek, and have acquired by agreement or unilateral action, equity participation in the operating companies.[1521] The laws of the developing countries regulating natural resources have been progressively modernised and are now, without doubt, more ascertainable.

8.4 CLAIM THAT DOMESTIC LAW UNSUITABLE ARGUABLY A RED HERRING

It is clear that one of the alleged problems of applying the law of a developing country to agreements was that it was too unsophisticated to regulate such complex economic agreements, and that such legal system was often not similar or close in content or stage of development to those of the investors.[1522] Even if this contention had any validity at one time, which is doubtful, given the fact that most of the

[1519] Robert Fabrikant, 'Pertamina: A Legal and Financial Analysis of a National Company in a Developing Country' (1975) 10 Texas Int'l L.J. 535.
[1520] *Ibid.*
[1521] Smith and Wells (n 1454); The Report of the General Assembly on Permanent Sovereignty Over Natural Resources U.N Doc A/C.97/5 Rev. 2 (E/3511); Investment Laws and Regulations in Africa U.N Economic Commission for Africa, U.N. Doc (1965) E/CN.14/INR/28/Rev.2.
[1522] McNair (n 1074).

developing countries have at one time or another shared a common legal association with some sophisticated legal system, the position has changed considerably in the last decades, as developing countries reform their laws and enact new legislation, mainly in the area of the development of their natural resources.[1523] These changes in the internal legal arrangements of developing countries for exploiting their natural resources signify their acceptance of the now universally acknowledged challenge that social and economic development is primarily their responsibility. The changes also echo the countries' belief in the significant role that natural resources are anticipated to play in their efforts.[1524]

In general, the rules and practices are designed, on the one hand, to encourage investment of foreign capital for oil and gas development, and on the other, to guarantee that oil and gas development by multinationals is carried out with appropriate regard to the country's national interest.[1525] It is a settled principle of law that such matters as, permanent sovereignty over natural resources ownership, control and management of oil and gas resources, and participation by nationals and host governments are enshrined in company polices and guidelines.[1526]

8.5 CLAUSES PROMOTING STABILITY EXTENSIVELY DISCUSSED AND PRESENTED

One of the themes to emerge from this analysis is that no agreement can exist in a vacuum but must be shaped and formed in the context of a legal system agreed upon by the parties to the agreement as binding upon the terms of the agreement. The legal system provides the norms by which genuine differences of opinion about the meaning of the terms of agreements can be resolved.

The view in the research has been that no model agreement can fulfil this objective because of the diverse circumstances and capabilities of the parties, particularly the host country. On the other hand, there are certain types of clauses which tend to

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[1523] For instance in the charter of Algiers adopted by the Ministerial Meeting of 77 Developing Countries, Oct.24, 1967, U.N. Doc. MM/77/1/20, reprinted in 7 *Int'l Legal Mat'ls* 177, 188 1968. The same conclusion was reached by many delegations in the Sixth and Seventh Special Sessions of the General Assembly.
[1524] See Natural Resources of Developing Countries: Investigation, Development and Rational Utilisation, U.N. Doc. E/4608/Rev. 1, ST/ECA/122 (1970); Mineral Resources Development with Particular Reference to the Developing Countries, ST/ECA (1968).
[1525] Martin Olisa, 'Comparison of legislation affecting foreign exploitation of oil and gas resources in producing countries' (1972) 10 ALTA Law Review 487.
[1526] *Ibid.*

promote the objectives of either of the parties without detriment to the remaining party, and to aid stability. For these reasons they are better included. There are also some clauses which have greater effect when they are phrased to reflect objectives or situations. Thirdly, there are clauses which promote contractual stability through all seasons because of their in-built flexibility.

What this study has attempted to do has been to emphasise the above and to provide a framework within which parties may negotiate and decide on variations which will suit their particular situations and allow for efficient exploration/development of the particular area.

8.6 THE INFLUENCE OF NATIONAL POLICIES ON AGREEMENTS

The study found that the policies on agreement, international or otherwise, later become the main basis for legislation governing oil and gas operations in the country. Similarly, amendments to oil and gas legislation are quite frequently derived from specific policies on particular aspects of oil and gas operations. Because of "diverse national interests, developing countries that produce mainly for export lay emphasis on measures designed to increase oil and gas revenue, whereas highly industrialised countries that have not attained self-sufficiency in oil and gas from domestic production give priority to measures for adequate and steady importation of cheap oil and gas to supplement domestic production".[1527]

It has been shown that economic nationalism directed against multinationals is fundamental to producing countries, wherein foreign companies have large stakes in their oil and gas industry. In several oil producing countries, these national imperatives are often enshrined in legislative provisions.

In joint venture arrangements the functions, powers and privileges of the foreign "partner" are more restrictive than in concessions. The host state has been able to participate to a greater extent, in the decision-making processes of exploitation of their resources by these multinationals. For example, nationals also participate at all levels in day to day operations, acquiring various skills in the process. The functions, powers and privileges of the foreign "partner" are so defined as to promote the national interest of the host country.

[1527] *Ibid* 487.

In a joint venture, the objectives of the multinational corporations and the home state will frequently be in conflict. The multinational corporation is driven by the need for instant profit. The home state entity, on the other hand, has long-term economic objectives of development and seeks to pursue these through the joint venture with the multinational corporation. The cooperation that is crucial for the success of the joint venture will be wanting in such an association and the probability for conflict is high.[1528]

Unlike the multinational corporations, the state agency has a claim to greater recognition in international law. There are rules of international law which give it an ideal standing and make it immune, to a degree, from the process of national courts. The entire matter of the applicability of sovereign immunity to State entities has been prickly but is now being resolved by the broad acceptance of the rule that such immunity cannot be claimed by a State entity which engages in commercial activity.[1529]

Multinational corporations have begun to take a long-term approach to the problem. As a result, they may be more willing to take an assuaging approach to such conflicts. Their self-interest in upholding oligopolistic positions in world markets may make it advantageous from their point of view to seek accommodation of their interests than to seek conflicts. There is also the problem that the State will be willing to back its entities by enacting laws that favour its entities in dealings with multinational corporations if the necessity for such a course arises.[1530] In such a state of affairs, the position of the multinational corporation becomes tenuous. In the face of an obdurate state, a multinational corporation has little by way of legal weaponry to use, at least if it wishes to preserve its relations within the State.[1531]

8.7 ECONOMIC PLANNING FOR THE FUTURE WILL BECOME CRUCIAL

The research has demonstrated that the producing countries are acutely aware that their economy is based upon a diminishing asset, and that unless they diversify their economy, they may lose their only chance to attain prosperity and development.[1532]

[1528] Sornarajah (n 3) 70.
[1529] *Ibid* 72.
[1530] *Ibid.*
[1531] *Ibid*.
[1532] Muir J Dapray,'The Changing Legal Framework of International Energy Management' (1975) 9 Int'l L. 605.

And it is specifically in these fields of economic planning, of science and technology, and of industrial development that the consuming countries can make available services to the producers. It is only when these matters are objectively addressed in the spirit of compromise and mutual benefaction, the prospects for world peace cannot be viewed very positively.[1533] The basic fact is that the world's economy cannot be left solely to the discretion of a single bloc of countries, whether they are producers or consumers. In the same vein, the world cannot be "allowed to regress from freedom and development to a kind of reverse imperialism".[1534] It is hoped that the producers will act from a sense of social responsibility to the world as well as to the communities where they carry out their operations. Such matters are urgent and crucial to the world's economy as it adjusts to the post-petroleum age.[1535]

The study is of the view that production sharing agreements are "based on the concept that the ownership of oil is always in the state and that the state alone has the right to its disposal, a reflection of the principle of permanent sovereignty over natural resources".[1536] The risk of oil exploration is borne by the foreign corporation, which is given a licence for the exploration of parcels of areas where there is a prospect of finding oil. When oil is found, the foreign corporation may extract the oil and is given a certain percentage of it, so that it may recover the expenses of the exploration and secure a reasonable profit. These findings are consistent with previous research, although there are areas in which they differ.[1537] The percentage of the oil given to the foreign corporation gradually diminishes as the expenses are recovered by sale, until the whole project is taken over by the state oil corporation.[1538] The state retains ownership of the oil, subject to the right of the foreign corporation to its share of production. There is usually provision for joint management of the project with the State oil company.[1539]

Both the joint venture agreement and the production-sharing agreement are legal arrangements which demonstrate that host states are asserting their power over incoming investments.[1540] The amount of power that can be asserted will depend on

[1533] Curtis (n 1022) 317.
[1534] Dapray (n 1025) 605.
[1535] *Ibid.*
[1536] Sornarajah (n 3) 144.
[1537] *Ibid.*
[1538] *Ibid.*
[1539] *Ibid.*
[1540] *Ibid.*

the relative bargaining strengths of the parties and will involve the realisation of the advantages of a fine balance. A state which is desperate for investment will be mindful of how it exercises its sovereign power. If it wishes to be perceived as a country that is attractive to foreign investment, it behoves the state to take advantage of foreign inflows, while ensuring that the foreign investor is privy to incentives that will encourage him to remain and do business in that state.[1541]

8.8 TO BEGIN AS ONE HOPES TO CONTINUE

This study has demonstrated that from the point of view of the developing countries, the joint venture serves three core purposes: (1) It encourages the engagement of responsible local capital in productive enterprises; (2) it assists in developing a nucleus of experienced managerial personnel in the public and in the private sectors, in proportion to the participation of public authorities and private capital in the joint venture; and (3) it assists in the enhancement of the training of native labour and technicians.[1542]

As developing countries progress in these respects, their need for joint ventures is expected to reduce. There is a general consensus amongst scholars that joint venture agreements are the preferred form of legal arrangement with foreign investors, when compared to outmoded concessions.[1543]

Notwithstanding however, it is not possible to determine whether existing joint ventures are likely to endure. It is possible that many of them will likely be replaced by wholly indigenous ownership and management, given the progressive nature of legislative amendments in their favour by the home state.[1544] Having said this, joint ventures do present advantages to both parties in that it involves the sharing of risk capital. It is also advantageous to other business entities, public relations and social constructs.[1545] Furthermore, human capital developed through joint ventures agreements will undoubtably endure beyond the lifespan of the said project. It is to be hoped that the most successful of the joint ventures may also embark in true

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[1541] *Ibid.*
[1542] Friedman and Kalmanoff (n 108) 262.
[1543] *Ibid* 262.
[1544] *Ibid.*
[1545] *Ibid.*

partnership on the process of jointly seeking broader alternatives to ensure mutual profitability once the petroleum resources have diminished.[1546]

8.9 HONESTY AND FLEXIBILITY BOTH NEEDED TO OVERCOME NEGATIVE FACTORS

The basic truth is that political and psychological circumstances sometimes mitigate against joint ventures.[1547] Where hard and unhinged circumstances prevail in a country, the association of a foreign investor with local interests may increase the precariousness of the situation. Pressure on the foreign firm may be increased through the local interests involved. The chosen partner may fall out of favour with a new government and prove to be a liability rather than an advantage.[1548]

The most prevalent and indispensable criteria are flexibility of mind and attitude, and the ability to evaluate the elements inherent in a country, a certain situation, and for a particular product or service.[1549]

The joint venture is an important symbol of the changing relationship between the developed and developing countries, but it cannot be regarded as a panacea. As Friedman and Kalmanoff summarise, "it is a device to be adopted, rejected, or modified after sober consideration of the many legal, psychological, and technical factors prevailing in each situation. Confidence between the partners will overcome the most difficult obstacles; lack of confidence will destroy the most perfect devices".[1550]

One element which contributes to lack of confidence and trust has emerged from studies which have indicated that the nature of the technology which has been exported has often been outdated and harmful.[1551] The extent of harm to the

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[1546] *Ibid.*
[1547] *Ibid* 264.
[1548] *Ibid.*
[1549] *Ibid.*
[1550] *Ibid.*
[1551] See generally, Abigail Ackah-Baidoo, 'Enclave development and 'offshore corporate social responsibility': implications for oil-rich sub-Saharan Africa' (2012) 37 Resources Policy 152; A S Macfarlane, 'The implementation of new technology in southern African mines: Pain or panacea' (2001) The South African Institute of Mining and Metallurgy; Jennifer Kuan, Seraphima Rombe-Shulman and Ekundayo Shittu, 'The Political Economy of Technology Adoption: The Case of Saharan Salt Mining' (2014) < https://pdfs.semanticscholar.org/4eec/ec44a7cae562e493971d60d118f8d3f38a5e.pdf> accessed 23 June 2018; and Ron Adner and Daniel Snow, 'Old technology responses to new technology threats: demand heterogeneity and technology retreats' (2010) 19(5) Industrial and Corporate Change 1655.

environment caused by the export of such technology has been identified in these studies, and there have been dramatic examples of the potential harm to both life and the environment that such outdated technology could cause.[1552] Such cases demonstrate that multinational corporations often use technology which are not permitted for use in their own home states, but do so in developing States because it is cheaper and there are no regulations or effective supervision to prevent their use.[1553] However, multinational corporations must also come to realise that as part of building long-term cooperation, it is not in their own interests to impose substandard technology on developing countries, if only because developing countries will not forever remain unaware of it.[1554]

8.10 DAWNING OF THE THEORY THAT THE MNC SHALL CONTRIBUTE TO ECONOMIC DEVELOPMENT

The study has further remarked that the existing model that multinational corporations can produce both good and harm to economic development. In view of this model, it is easy to espouse the view that foreign investment should be employed to achieve economic development, which ultimately requires judicious regulation. For example, several developing countries have now enacted legislation to set up screening bodies which permit entry to or give incentives to investments which are approved by them. On the global arena, this model has been the basis on which the code of conduct for multinationals are being formulated.

However, these views challenge many propositions in international law which have been formulated on the basis of a new theory. Unlike the traditional approach, which favoured liberalisation and the freedom of movement for multinational corporations on the assumption that this promotes development, the latest theory requires the recognition of the right of regulation of the foreign investment process by the host state.[1555]

The traditional theory mandated absolute rules of investment protection and their uniform application to all investments.[1556] The basis of this position has been shaken by the increasing acceptance of the view that foreign investment should be entitled

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[1552] Sornarajah (n 3) 62.
[1553] *Ibid.*
[1554] *Ibid*.
[1555] *Ibid* 66.
[1556] *Ibid.*

to protection only on a selective basis. Protection depends on the extent of the benefit it brings the host state and the extent to which the enterprise to be protected has conducted itself as a good corporate citizen in promoting the economic objectives and interests of the host State.[1557] There is no obligation to abide by the laws and regulations of the host state which are designed to capture the maximum benefits the foreign investment can bring to the host state's economic development. The *quid pro quo* for existing and profiting from operations in the host state for the multinational corporation is that it should ensure that the laws that seek to enmesh its operations with the economic objectives of the state are complied with.[1558]

8.11 MIX OF REGULATION AND OPENNESS

The study's view is that the extensive regulatory regimes which existed in the past have given way to new supervisory regimes based on realism. The approach of rapid industrialisation desired by developing countries requires capital which only multinational corporations can provide.[1559] This certainty requires the adoption of new policies that show a willingness to accommodate the interests of multinational corporations.

What is more, the institution of administrative controls is necessary to enhance the economic objectives of the State in receiving the foreign investment. A uniform view that all investment must be protected through international minimum standards is no longer a feasible notion, as the practices of States indicate that they do not subscribe to the idea that all foreign investment is entitled to such a minimum standard.[1560] The externally imposed minimum standard insulates the multinational corporations without the creation of any corresponding duties. That idea must be abandoned in view of the competing notions that extend protection only to multinational corporations which act in accordance with the laws and policies of the host states in which they function. In the alternative, such a minimum standard exists only to the extent that the multinational corporation abides by the regulatory standards mandated by the host state. International law itself may impose a requirement of conformity with environmental standards upon actors such as multinational

[1557] *Ibid.*
[1558] *Ibid.*
[1559] *Ibid.*
[1560] *Ibid.*

corporations.[1561] Acquiescence with domestic laws is a prerequisite to admittance. These remedies may evolve but not without a division in law; the evidence of such a spit will be seen in deciding when a regulatory meddling amounts to an expropriation for which compensation needs to be paid.[1562]

Notwithstanding the downside of PSCs in general, and the oppressive tax rates and other provisions which might make PSCs time-consuming for the parties involved, they still appear to be the most feasible option for oil producing developing countries in making the most of their oil industry potential, not least because they facilitate a gargantuan degree of control over private petroleum operations.[1563] In effect, the PSCs allow the host oil-producing countries to "nationalise" their petroleum resources (by retaining ownership rights to the concessions) whilst at the same time attracting a much desired and direct involvement of foreign private enterprise. The PSC is also nostalgically seen as an attractive experiment of the early 1970s, having regard to the subsequently prevailing problems of an insufficient technological base and unskilled workforce, combined with perennially inadequate financial resources which beleaguered developing countries.[1564]

8.12 PSC vs JV UNDER THE IMPACT OF THE ECONOMIC DECLINE

In the later part of last century, the reality of developing countries' deteriorating economic fortunes and their persistently increasing deficits and debts made other forms of contractual relationships (particularly PJVs) very unattractive. In Nigeria for instance, as a direct result of the Federal Government's recent inability to meet its joint venture funding obligations and the unlikelihood of it succeeding in this regard in the near future, the PSC appears to proffer some relief.

The new financing arrangements will not generate significant shifts in the allocation of financial benefits. However, in industries where bargaining powers continue to shift in favour of the host country, and where host country negotiation skills are sufficiently strong, the changes will be more than political.[1565] There will be real changes in who controls the operations and who receives the financial benefits from the projects. The concept of ownership may have lost some of its significance for

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[1561] *Ibid.*
[1562] *Ibid.*
[1563] *Ibid.*
[1564] *Ibid* 66.
[1565] Smith and Wells (n 1507).

managers of companies with experience in arrangements which confer sufficient control over fundamental decisions and provide attractive financial benefits to the company, with little direct claim to ownership.[1566] Nevertheless, the new forms of agreement, while providing a means of sharing symbolic power and economic benefits in ways the traditional concession could not, have not purged the complex technical problems relating to the allocation of financial benefits and risks.[1567]

The advantage of the joint venture arrangement lies in its negligible risk exposure and guarantee of profit, since it applies only to reputable commercial and producing assets anywhere the risk of exploration are hitherto been removed.[1568] In fact, in Nigeria under the terms of the 1991 Memorandum of Understanding (MOU) to which all the joint venture companies are signatories a profit-investment ratio of about 65 per cent is guaranteed the investor, even at low prices.[1569] The joint venture arrangement in Nigeria is a comparatively low risk, high reward investment by Government, even with titular supervision of its stake in the venture.[1570] Nonetheless, there is a catch to the continued enjoyment of these high rewards: it must be cautious enough to make satisfactory provision for working capital and at the appointed time to pay cash calls.[1571] Developing countries which are still at an early stage in their petroleum activities should exhibit a realistic altitude when studying and learning from experienced producers.

The PSC is an important effort to equalise the historic balance between the producing countries and the foreign petroleum companies. Although the contracts exaggerate the actual shift in power between the parties, they provide an appearance of equality as well as a means for ultimately achieving such equality.[1572]

8.13 QUESTIONS OF DE FACTO CONTROL AND SHARING

Notwithstanding the changes in the Nigerian oil industry over the past 50 years, *de facto* control is still in the hands of the multinational corporations. This is primarily

[1566] *Ibid.*
[1567] *Ibid.*
[1568] Friedman and Kalmanoff (n 108).
[1569] Akinrele (n 430) 312. Due to inflation, which had eroded the guaranteed profit margin, as well as changes in the operating environment, the 1991 MOU was replaced by a new MOU introduced in the year 2000 for a period of three years, with the capacity to be extended by mutual agreement of the parties.
[1570] See generally, G K N Ogunlami, 'An Analysis of Nigerian Petroleum Profit Taxation' (1989) CEMPL.
[1571] See generally, Gidado (n 392).
[1572] Fabrikant (n 611) 351.

since the petroleum contracts and some government policies towards development of the petroleum products are not sufficiently designed to enable local control and full participation as well as to have an effectual transfer of technology. Currently, the government's participation in the oil industry is only noticeably limited to profit sharing.[1573] Such areas as operational strategies of the subsidiary oil companies are still in the hands of the multinational and are thus under the whim and caprice of their parent companies in Europe and America. If the goals of the host government are to be realised, the Government must go further than majority shareholding and secure *de facto* control of the operational policies of the subsidiary oil companies. This may possibly be achieved through the setting up of efficient management committees to run the affairs of the oil companies, with the government interest rightly protected.[1574]

There is the view (that is favoured by this study) that the sharing of representation at the level of the Board of Directors of the subsidiary oil companies does not in any way guarantee *de facto* control. Neither does majority shareholding. The fact is that the government has been unsuccessful in arriving at a coherent understanding of what it means by control as enshrined in section 1(1) of the Petroleum Act. The absence of *de facto* control by the Nigerians of the oil sector will continue until there is a clearer enunciation and execution of government goals. This is clearly demonstrated by the fact that despite over 50 years of petroleum operations in the area and the huge oil revenue derived for the nation, the physical and socio-economic conditions of the inhabitants of oil producing communities remain deplorable. The low quality of living of the inhabitants is revealed by the high poverty threshold, poor housing conditions, high rates of unemployment, and collapsed or non-existent social and infrastructural facilities. To date, the benefits that were expected to be derived from the very high oil revenues nonetheless seem to have eluded or had only infinitesimal effect on the oil communities. In its place, there is manifest social decay and underdevelopment, as well as a cavernous gap between people's expectations and what the government and oil companies consider obligatory to put in place.

[1573] S B Falegan and G O Okah, 'The Contribution of Petroleum to the Nigerian Economy' in *Oil and the New International Economic Order, Proceedings of the Annual Conference of the Nigerian Economic Society* (Ibadan: The Nigerian Economic Society 1976) 163, 184.

[1574] *Ibid.* In 1991, NNPC signed its first joint operating agreement (JOA) with a transnational oil company. Under a JOA, a management committee comprising representatives of the Joint Venture partner is set up.

8.14 THE CONTINUED ABSENCE OF PALPABLE BENEFIT FOR THE IMPOVERISHED

Notwithstanding the enormous earnings from crude oil, the expected dividends in terms of socio-economic development, job opportunities and employment, physical infrastructure, essential social sector infrastructure such as education, health, electricity, telephone, etc. have not been realised. In its place, the industry has created irretrievable social, health and environmental problems, particularly for the host communities in Nigeria's oil province. Recognised to be operating in a lax environment with little or no accountability and transparency, the oil industry has been accused of nurturing a group of highly corrupt technocrats, business and political elites, whereas most local inhabitants wallow in penury and abject poverty.

Oil-related environmental, political and human rights abuses were, and still are commonplace.[1575] As a result, long years of acute neglect and social frustrations have elevated the level of anger amongst the inhabitants of the oil communities against the government and multinational oil companies operating in the area. Most attempts by the Government and oil companies to address the countless challenges precipitated by oil production have achieved only limited qualitative results.[1576] Likewise, there is presently a paucity of innovative strategies for conflict prevention, management and resolution in the area. It also well known that official responses to the oil-goaded violent conflicts have only served until now, to exacerbate this unpredictable social state of affairs. Nowadays the semantics of violence have been complicated by a politically-motivated clamour for resource control and ownership of petroleum resources by the oil communities.[1577]

8.15 ORIGINAL CONTRIBUTION

In addition to the provision of some directions for future research, this study has made modest contributions to the currently existing wealth of academic writing on the legal framework of petroleum exploration and production. Even though the focus is on the petroleum industry, this study is intended to make meaningful contributions, particularly to the legal framework of extractive industry and natural

[1575] Emeka Duruigbo, O Wozniak and M Leighton 'Oil Development in Nigeria: A critical investigation of the Chevron Corporation's Performance in the Niger Delta' (2001) *Field Research and Report Writing, California Global Corporation Accountability Project*.
[1576] *Ibid.*
[1577] *Ibid.*

resources in general. Apart from adding to the body of existing scholarly writing, other research will take place in future in the same field; and directions for future scholars and researchers to explore.

Further, to advance legal discussion in international commercial law, especially in the sphere of international development agreements. This study will act as a catalyst for the on-going improvement of oil and gas by encouraging the industry worldwide to adopt the key features of production sharing contracts and joint venture agreements and, in the long term, to continually improve and refine them.

8.16 RECOMMENDATIONS

The study recommends policy changes to make public a shift in goals from output maximisation to poverty reduction through:

1. The Government should use its sovereign power to strengthen the preventive and safety requirements for all drilling activities.

2. The Government must require all mineral extracting firms to adopt state-of-the-art technology that would eliminate (or at least minimize) damage to the environment and its inhabitants.

3. The Government should join with the oil firms and the local community in seeking feasible ways and means of cleaning up existing pollution.

4. The production of good and services at a reduced rate for the poor.

5. The creation of job opportunities in oil producing areas.

6. The building of public essential services, schools, roads, hospitals etc.

This study is of the opinion that any effective integrative socio-economic development approach should be in harmony with the cultural sensitivities of these communities. Attention must be made to address the long and painful legacies of degradation and deprivation experienced inhabitants of resource-bearing regions. It points to the fact that lack of institutional mechanisms for local participation in the oil industry, especially on matters that affect the communities, may be partly responsible for the level of social anguish and ill feelings by host communities.

Accordingly, only the future can determine whether the host government can successfully promote and protect human and environmental rights after decades of government collusion and negligence. There are promising signs, especially with the Niger Delta Development Commission ("NDDC"). Generally, the Commission's mandate comprises addressing the substantive grievances of different communities, both oil-producing and non-oil-producing, in the nine states that are included in the Niger Delta. While local control of oil and gas resources may not be practicable, the present government provides another golden opportunity for government to distribute the benefits downwardly in a just and equitable method.

The adoption of good credit and good oil-field practice is for multinational oil companies and government to carry out oil-producing activities in a socially, economically, politically and environmentally responsible manner. This can only be achieved when the citizens, particularly the host communities, are able to partake in, and enjoy the benefits and rights deriving from their God-given resources. Hence, intervention strategies for environmental assessment and sustainable development should adopt a participatory development practice, which guarantees the people's right to participate in decision making and implementation in matters that affect their communities and environment.

8.17 SPECIFIC AMENDMENTS TO ENCOURAGE DEMOCRACY AND SUSTAINABLE DEVELOPMENT

The Nigerian government should take several steps to continue its commitment to democracy and sustainable development:

Political leaders should create a stronger legal and policy framework for oil development by removing redundant provisions and updating outmoded laws. A Fund should be established to assist victims of environmental and human rights abuses to litigate their claims in court. This will help to promote a culture of accountability.

The judiciary should take every necessary action to ensure that public confidence in the courts is restored. Otherwise people will continue to resort to overseas litigation against oil companies in Nigeria.

The police should be weaned from warring tendencies accumulated during decades of dictatorship by retraining; this is especially important in cases of peaceful protests.

Multinationals can and should use the changes taking place in Nigeria as a basis for building a more sustainable, less damaging oil industry. It should incorporate a philosophy of community development that looks beyond immediate needs and prepares members of local communities for a self-reliant future. It should work with the government to fashion an alternative economic base for oil communities where petroleum production has destroyed traditional means of survival such as farming and fishing. Lastly, it should open its activities to the scrutiny of independent assessors. For that reason, international government and non-governmental agencies should be involved in monitoring the companies' compliances with existing laws and their business policies in areas such as environmental protection and community development. They can only benefit from the rights to forcefully insist on control over their own resources and the enforcement of meaningful standards to remedy past harm and prevent future damage. When the oil is gone, its legacy remains.

APPENDIX

Table 1
Funds contribution to Joint Venture by government and Joint Venture companies

	NNPC		**Joint Venture Partner**		**Total**	
Years	$ billion	N billion	$ billion	N billion	$ billion	N billion
2006	2.19	206.33	2.91	192.56	4.59	398.89
2007	2.62	295.75	1.69	183.13	4.32	476.88
2008	2.51	291.83	2.56	287.17	5.11	579.87

The findings in Table 1 – From the above findings, in PSCs, Multinationals bear all exploration and development costs. This is in line with the findings of the commentators Atsegbua, 1999 and Muhammad, 2010. They are of the view that exploration and development costs are borne 100 per cent by the contractors, therefore, bearing all the risks of the contracts. From these findings, it can be safely found that a Joint Venture contract is more beneficial to the host country.

Table 2
Royalty Payments

Years	JVs (Barrels)	PSC (Barrels)
2007	462,888,989	192,621,306
2008	471,900,351	195,127,693
2009	331,554,144	268,792,256
2010	364,717,172	316,887,117
2011	348,509,885	289,333,720

Source NNPC (2011)

Omorogbe has observed that "money received by the owner of a resource as compensation is based on production volume irrespective of production cost and prices."

Table 3
Depth of the Sea

Area in metres	Percentage of Crude found
0-100 m depth	18.5%
101-200 m depth	16.5%
201-500 m depth	12.0%
501-800 m depth	8.0%
801-1,000 m depth	8.0%
Over 1,000 m depth	8.0%

Source NNPC (2011)

Accountability and Transparency

According to Sani Saidu, Hamidu Abubar Sadiq observed that the NEHI 2001-2008 reconciliation report found "different difficulties and system weaknesses in the Nigerian oil and gas industry which stem from lack of accountability and transparency in the transactions between the parties involved and the general public."

Table 4
Petroleum Profit Tax (PPT) Payment by JV Companies

Years	Government $	JVC Companies $	Difference Adjusted	Difference Adjusted Price
2006	9,775,427	8,784,861	990,566	10,022,955
2007	7,105,070	7,798,048	-692,778	7,250,050
2008	8,298,906	9,063,000	-764,094	10,189,225

Source NATI 2006-2008 Audit Report

From Table 4, PSCs are more beneficial in terms of transparency and accountability because in PSCs multinationals are 100 per cent responsible for all the costs and risks, and that the PPT charge is based on the reported production. This finding is supported by Oyefusi (2007) and Ocheje (2006), who observe that "more contained a very complex formula that was not easily understood by a majority of stakeholders in the industry." It can be safely concluded from the report that this action by the multinationals thwarts transparency and trounces verification and the accountability of PPT assessment.

Table 5
Rate of Return of Questionnaires

Companies	**Number of Questionnaires Given**	**Number of Questionnaires Returned**
Royal Dutch Shell Plc	30	10
ExxonMobil Plc	50	6
Chevron Plc	50	4
Agip Plc	20	1
Petrobras Plc	20	4
Total Plc	10	2
Statoil Plc	10	2
Handy Oil and Gas Plc	30	4
Nexin Incorporated Plc	10	3
Addax Plc	10	1

This data was carried out between July -September 2016. Out of the 140 questionnaires sent out, 37 questionnaires were returned. Extractive activities by multinational oil companies stated have caused severe environmental and social damage in the Niger Delta. Crude oil extractive has caused pollution to the river's basin and the surrounding land as well as the expropriation of host communities. The opposition of the host communities had been severely oppressed by police forces resulting in blood shed and hundreds of fatalities. Host communities supported by successionists movements including the Movement for the Emancipation of the Niger Delta, have continued their opposition to those exploitative polices. Basically, they demand a full clean-up of water ways and territories as well as a more equitable distribution of oil revenues, including broader compensation for ecological damage.

Table 6
Response rate to the Issue of Control

Options	**Joint Venture**	**Production Sharing Contracts**
Very high rate	0	0
Considerably high rate	0	0
High rate	2	40
Low rate	20	50
Very low rate	20	50

This data was carried out between July-September 2016. This table shows that the respondents believe that the management of the joint venture and production sharing contracts, to a large extent, is still a distant goal. Control still resides with the multinationals.

Questions asked in Questionnaire

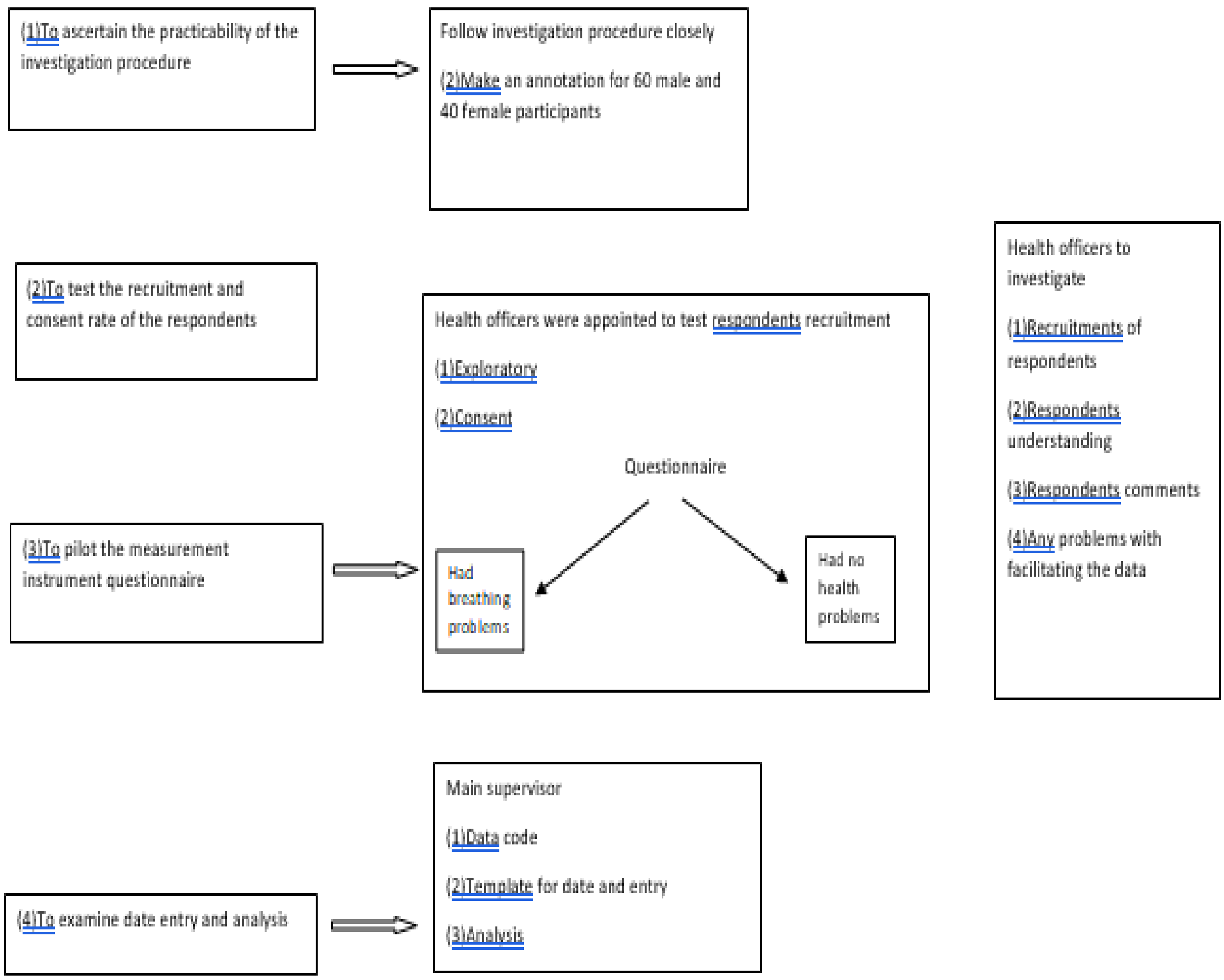
Questions on the company

1. How would employers rate your company and the work environment?
    a. Are employers satisfied with the direction of the company?
    b. Do employers feel engaged with the employees of the company?
2. Across departments, what are the employer's opinions of the management?
    a. Do supervisors and managers communicate expectations in their direct reports?
    b. Are the goals ambition of the company clear?
3. What is your opinion about joint venture and production sharing contracts?
4. What major changes do you perceive from the workability of these arrangements?

Questions on the responsibility of work

1. What are your feelings about your work?
2. Can you describe briefly on the impact of your work on your life generally?
3. Have you been offered any opportunities for formal training to advance your career with the company?

Flow Chart of the Study



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